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**CMA FINAL
PAPER 17**

COST AUDIT

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INDEX

S.NO	CHAPTERS	PAGE NO.
1	BASICS OF COST AUDIT	1.1 - 1.7
2	COMPANIES (COST RECORDS & AUDIT) RULES 2014 (AS AMENDED)	2.1 - 2.15
3	OVERVIEW OF COST ACCOUNTING STANDARDS AND GACAP	3.1 - 3.72
4	COST AUDITING AND ASSURANCE STANDARDS	4.1 - 4.4
5	COST AUDIT PROGRAMME	5.1 - 5.11
6	COST AUDIT DOCUMENTATION, AUDIT PROCESS & EXECUTION	6.1 - 6.4
7	PREPARATION & FILLING OF COST AUDIT REPORT	7.1 - 7.3
8	COST AUDIT	8.1 - 8.23
9	BASIC OF MANAGEMENT AUDIT	9.1 - 9.8
10	MANAGEMENT REPORTING ISSUES & ANALYSIS	10.1 - 110.8
11	MANAGEMENT AUDIT IN DIFFERENT FUNCTIONS	1.1 - 11.8
12	INFORMATION SYSTEMS SECURITY AUDIT	12.1 - 12.5
13	EVALUATION OF CORPORATION IMAGE	13.1 - 13.13
14	OPERATIONAL AUDIT AND INTERNAL AUDIT UNDER COMPANIES ACT, 2013	14.1 - 14.8
15	AUDIT OF DIFFERENT SERVICE ORGANISATIONS	15.1 - 15.6
16	FORENSIC AUDIT	16.1 - 16.5
17	ANTI-MONEY LAUNDERING	17.1 - 17.6

BASICS OF COST AUDIT

Introduction to Cost Audit

1. **Meaning:** Cost Audit involves an examination of
 - a. cost books,
 - b. cost accounts,
 - c. cost statements and
 - d. Cost Accounting System
 - e. with a view to satisfying the auditor that these represent true and fair view of the cost of production.
2. **According to CIMA London**, cost audit is
 - The verification of the correctness of cost accounts and of the adherence to the cost accounting plan.
 - In other words,
 - cost audit is the verification of the cost of production of any product, service or activity.
 - on the basis of accounts maintained by an enterprise in accordance with the accepted principles of cost accounting
3. As defined by The **Institute of Cost Accountants of India**,
 - Cost audit as a system of audit introduced by the Government of India
 - For the review, examination and appraisal of
 - The cost accounting records and attendant information, required to be maintained by specified industries.
4. **Important points:**
 - ✓ Cost Audit is an innovation introduced for the first time in the world and India with a view to regulate industries on healthy and sound lines.
 - ✓ Cost Audit is for cost-effective products and services to customers, proper revenue to government's treasury and proper returns to other stakeholders of the enterprise.
 - ✓ India is the first country in the world introducing the legal provisions for compulsory maintenance of cost records, so that industries become cost conscious and industrial efficiency is increased for the benefit of the society as a whole.
 - ✓ It fully conforms to the requirements of planning for 'sustainable development'.
 - ✓ Thus, Cost Audit in India refers to the Statutory Cost Audit of the selected companies covered under the relevant provisions of the Companies Act, 2013.

These requirements are mandatory, and non-compliance may invite penal provisions also.

History of Cost Audit in India:

- Cost Audit was first introduced in India with the introduction of Sec 233B of Companies Act 1956 for Cost Audit and Sec 209 (1) (d) for maintenance of Cost Records - in the year 1965.
- 44 Industries covered under cost record maintenance & cost audit on a company specific

basics-

during the years 1965 to 2008.

- Expert Group set up to study the existing system of maintenance of cost accounting records and audit in the year 2008 which submitted its report to CG during the year 2009.
- Introduction of mandatory Cost Audit of Cost Records maintained by the Companies under Companies Act 1956 for Manufacturing, Mining and processing operations on the basis of turnover and Net worth limits and issuance of Compliance certificate- during the year 2011.
- New Companies (Cost Records and Audit Rules), 2014 issued under Companies Act 2013 during the year 2013.

RELEVANCE of Cost Audit in India

- **Helping government for price regulation:**
 - The main reason for the introduction of cost audit in the initial years was to help government for regulating price in important industries like cement, steel pipes and tubes etc. which are very important for growth of the economy.
 - The government used these cost audit reports for regulating price of such important products.
- **Impact of liberalization and globalization:**
 - liberalization and globalization lead to massive industrialization and rapid growth of economy due to which cost data and cost audit has gained more importance than ever.
 - Gaining importance for cost data resulting in ongoing amendments in the cost audit reports which needs to be submitted to government or management.
- **Competition:**
 - The Cost Audit report is an effective tool which can be used to set competitive prices in the highly competitive markets.
 - Competition can be taken care of by undertaking proper study of the cost audit report which highlights important issues like efficiency, wastage, costs etc.
 - The competition law prohibits selling goods below cost. The cost audit report can be used by the Regulatory and enforcement authority of the competition law in India.
- **Facilitate levy of CVD:**
 - As a result of Free foreign trade policy many foreign countries like China dump their products at very low prices.
 - Such dumping of products affects the local domestic market.
 - Cost Audit reports can be sued for levying anti-dumping duties on products imported from countries like China.
 - It can also be used if there is an allegation from foreign country that goods are dumped by India at substantially low prices.
- **Facilitate fixation of ALP**
 - In the case of export sales Arm's Length Price (ALP) is often calculated by the Transfer Pricing Officer. Cost Audit Report serves as an important source of cost

information for calculating transfer price.

➤ **Government subsidies**

- Cost Audit report is also used by the tariff commission for fixation of price and for calculating subsidies that are required to be given to the industries for making their products competitive.
- Various incentives are given by the government to promote the local industries. Such incentives are calculated by the help of cost audit reports.

Objectives of Cost Audit

- ✓ The objectives of Cost Audit can be broadly classifiable into the following two types.
 - General Objectives
 - Social objectives
- ✓ **General objectives:** The following are various general objectives of Cost Audit
 - a. To evaluate compliance with Cost Accounting system:**
Verification of cost accounts with a view to ascertaining that these have been properly maintained and complied according to the cost accounting system followed by the enterprise.
 - b. Compliance with Cost Accounting Record rules:**
Ensuring that the prescribed procedures of cost accounting records rules are duly adhered to.
 - c. Detection of errors and frauds**
 - d. Inventory Valuation:** Determination of inventory value
 - e. Verification of cost of each cost unit and cost center**
 - f. Price Fixation:** To facilitate the fixation of prices of goods and services
 - g. Reconciliation:** To Periodically reconcile between cost accounts and financial accounts.
 - h. Optimum resource utilization:** To Ensure optimum utilization of human, physical and financial resources of the enterprise.
 - i. To Detect and correct abnormal loss of material and time**
 - j. To inculcate cost consciousness**
 - k. Advice to Management:** Advice to management on the basis of inter-firm comparison of cost records, as regards to the areas where performance calls for improvement.
 - l. Corporate governance:** Promoting corporate governance through various operational disclosures to the directors.
- ✓ **Social objectives:** The following are various social objectives of cost audit.
 - a. Reasonable Price fixation:** Facilitation of fixation of reasonable prices for goods and services produced by the enterprise.
 - b. Productivity improvement:** Improvement in productivity of human physical and financial resources of the enterprise.
 - c. Optimum allocation of resources:** Channelizing of the enterprise resources to most optimum productive and profitable areas
 - d. Facilitating Contract pricing:**
 - Availability of audited Cost data as regards contracts containing escalation clauses

- Facilitation in settlement of bills in the case of cost-plus contracts entered into by the government.
- e. **Protecting stakeholder's interest:** Pinpointing areas of inefficiency and Mismanagement if any for the benefit of shareholders, consumers and society in large.
- f. **General Analysis useful for public:** Hospitalization, schooling, roads and transportation facilities to own employees as well as neighboring people and cost benefit analysis.

Advantage of cost Audit

1. Cost Audit

- The term cost audit means a systematic and accurate verification of the cost accounts and records and checking of adherence to the objectives of the cost accounting.
- In cost audit, auditor has to perform the following duties:
 - Examine the correctness of the cost records maintained by the concern, and
 - To report as to whether the cost accounting plans have been adhered to or not.

2. Advantage of cost Audit:

To the Management:

- a. Management gets reliable data for its day-to-day operations like price fixing control, decisionmaking, etc.
- b. Close and continuous check with respect to all wastage's will be kept through a proper system of reporting to management.
- c. Inefficiencies in the working of the company will be brought to light to facilitate corrective action.
- d. Management by exception becomes possible through allocation of responsibilities to individual managers.
- e. A system of budgetary control and standard costing will be greatly facilitated.
- f. Reliable checks on valuation of closing stock and work-in-progress can be established.
- g. Helps in detection of frauds and errors.

To the shareholders:

- Cost Audit ensures that proper records are kept as to purchases and utilization of material and expenses incurred on wages, etc.
- It also makes sure that the valuation of closing stock and work-in-progress is on a fair basis. Thus, the shareholders are assured of a fair return on their investment.

3. Disadvantage of Cost Audit

- Accountants cannot estimate price of assets at current values.
- Only covers cost of business does not overcome overall profitability.
- Manipulations in accounts still exist.
- Standards of accounting vary from business to business,

COST AUDITORS

- **Disqualification for appointment as Cost Auditor:** As per Sec 141 of Companies Act, 2013, the following persons are **not eligible for appointment** as cost auditor.
- A body corporate
 - An officer or employee of the Company
 - A person who is a partner or employee to an officer or employee of such company.
 - A person either directly or indirectly holding any security of such company or its subsidiary or its holding or associate company
 - A partnership firm, if any of relatives of its partner holding any security in the company of face value exceeding Rs. 1 lakh
 - A person who is indebted to the company or its subsidiary, or its holding or associate company for an amount exceeding Rs. 5 lakhs.
 - A person who has given any guarantee or security in connection with the indebtedness of any third person to the company or its subsidiary, or its holding or associate company for an amount exceeding Rs. 1 Lakh
 - A person or a firm having business relationship either directly or indirectly with the company or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company.
 - A person whose relative is a director or employee of such company
 - A person who is in the full-time employment elsewhere or a person or a partner of a firm holding appointment as its auditor if such person or persons is at the date of such appointment or reappointment holding appointment as a auditor of **more than twenty companies**
 - A person who has been convicted by a court for an offence involving fraud and a period of **ten years has not elapsed** from the date of such conviction.
 - Any person whose subsidiary or associate company or any other form of entity, is engaged as on date of appointment in providing specialized services to the company and its subsidiary companies as below.
 - Accounting and bookkeeping services
 - Internal audit
 - Design and implementation of any financial information system
 - Actuarial services
 - Investment advisory services
 - Investment banking services
 - Rendering of outsourced financial services
 - Management services

Sec 148: Maintenance of Cost Records and Cost Audit:

1. Maintenance of cost accounts/records-Sec 148(1):

- The central government can order maintenance of cost accounts/records comprising particulars relating to

- for Utilization of material or labor or
 - Other items of cost as may be prescribed.
 - b. Such order may be for specified class of companies, engaged in production of specified goods or providing prescribed services.
- 2. Cost Audit-Sec 148(2):**
- Cost audit is the audit of cost records. It is an audit process for verifying the cost of manufacture or production of any article on the basis of accounts as regards utilization of material or labor or other items of costs, maintained by the company.
 - The central government may, if it feels necessary, direct by an order that an audit of the cost records kept by a company shall be conducted in the prescribed manner.
 - Such order relating to cost audit shall be given in case of companies:
 - ✓ Which is covered U/sec 148(1), i.e. maintenance of cost records / accounts and
 - ✓ Which have a Net worth or turnover of prescribed amounts.
- 3. Cost Auditor-Sec 148(3):**
- a. Cost audit shall be conducted by a cost accountant in practice (either individual or firm)
 - b. A statutory auditor of the company U/sec 139 cannot be a cost auditor of the company.
 - c. Cost auditor shall comply with the cost auditing standards issued by the Institute of cost Accountants of India, with the approval of the central government.
 - d. The appointment and remuneration of cost accountant is as under:
 - **If audit committee is required U/sec 177:** Cost auditor shall be appointed by Board, on the recommendations of the audit committee. Remuneration is recommended by the audit committee, approved by BOD and ratified by shareholders.
 - **If audit committee is not required U/sec 177:** cost auditor should be appointed by BOD on its own. Remuneration of cost auditor should be fixed by Board of Directors and ratified by the shareholders.
 - e. Cost audit shall be in addition to the audit conducted U/sec 143.
- 4. Rights, Duties of Cost Auditor-Sec 148(5):**
- a. The qualifications, disqualifications, rights, duties and obligations applicable to auditors under Chapter X (Statutory auditor) are applicable to cost auditor also.
 - b. The company is duty bound to give all assistance and facilities to the cost auditor for auditing the cost records.
- 5. Cost Audit Report-Sec 148(5), (6), (7):**
- a. The cost auditor shall submit his report to the Board of Directors of the company.
 - b. Within 30 days from the receipt of cost audit report, the company shall furnish full information and explanation on every reservation or qualification contained in the cost audit report, to the central government.
 - c. If the central government calls for further information and explanations, the company should furnish the same within the timeframe specified by central government.
- 6. Non-compliance-Sec 148(8):**
- a. The company/officer in default is punishable in the manner provided in Sec 147(1)

- b. The cost auditor is punishable in the manner provided in Sec 147(2) to (4)

Duties of Cost Auditor

- **General:** The duties of a cost auditor are similar to those of statutory auditor of a company.
- **Additional Duties:** In addition to those duties certain additional duties are also cast on cost auditors which are as follows:
 - a. **Proper books:** Cost auditor shall verify and ensure that proper books accounts are required by cost accounting records rules have been kept by the company. He is also duty bound to verify the returns of those branches which are not visited by him.
 - b. **Prescribed form:** Cost auditor shall ensure that the cost audit report and the detailed cost statements are in the form prescribed by cost Audit Report rules.
 - c. **Verified Data:** Cost auditor's report shall be based on data which is verified by him.
 - d. **Observations and Comments:** Cost auditor is duty bound to include observations in his report only after the company has been given a chance of commenting on the same.
 - e. **Apportionment of Indirect expenses:** Auditor is duty bound to ensure that the indirect expenses are properly allocated and are absorbed on a reasonable basis.
 - f. **Reasons for qualifications:** To qualify report if there is any need and to give reasons for any qualifications in his report.
 - g. **Copy of Cost Audit Report:** To forward the cost audit report within the prescribed time period.

Cost Accounting Standards:

1. **Meaning:** CAS are set of standards that are designed to achieve uniformity and consistency in cost accounting principles and practices.
2. **CASB:** The ICAI has constituted Cost Accounting Standards Board with the objective of formulating the Cost Accounting Standards.
3. **Objectives:** The following are various objectives behind formulation and issuance of CAS.
 - ✓ To Provide a **structured approach** to measurement of costs in manufacturing process or service industry.
 - ✓ To Integrate, **harmonize**, and standardize cost accounting principles and practices.
 - ✓ To **Provide guidance to users** to achieve uniformity and consistency in classification, measurement, assignment, and allocation of costs to products or services
 - ✓ To Arrive at the **basis of computing the cost of product**, activity, or service where required by legal or regulatory bodies.
 - ✓ To Enable practicing members to **make use of CAS** in the attestation of General-Purpose Cost Statements.
 - ✓ To Assist in **clear and uniform understanding** of all the related issues of various user organizations, government bodies, regulators, research agencies and academic institutions.

COMPANIES (COST RECORD & AUDIT) RULES 2014

Rules 1: - Short title and Commencement

Rule 2: - Definitions

Rule 3: - Application of cost records

Rule 4: - Applicability of cost Audit

Rule 5: - maintenance of cost records

Rule 6: - Appointment of cost auditor

CRA 1: - Maintenance of cost records

CRA 2: - Intimation to central govt

CRA 3: - Cost audit report

CRA 4: - Filing of cost audit report in EBRL mode (extensible business reporting language)

Rule:1 Short title, commencement

- Short title = companies (cost records & audit) Rules 2014
- These rules are implemented in India w.e.f 30/6/14

Rules:2 definitions

- ✓ ACT
- ✓ Cost Accountant in practice
- ✓ Cost Auditor
- ✓ Cost Audit report
- ✓ Cost records
- ✓ Institute

Rules:3 Application of cost records

- a) Every domestic or foreign company which is covered under regulated sector or non-regulated sector require to maintain cost records for their products or their services.
- b) Regulated sector covers those products or services under Table A.
- c) Non-regulated sector covers those products or services under tables B.
- d) The limit of turnover preparation of cost records is ₹35 crore or more preceding year, for products or services covered under table A or table B or both.
- e) The micro enterprise or small enterprise as per MSMED Act, 2006 are exempt from cost records.
- f) It is clarified that we have to see total turnover for ₹ 35 crores limit but cost records are mandatory for table A and table B products.

Rules: 4 Applicability for cost Audit

- 1) Regulated sector such as telecommunication, electricity, petroleum & gas, drugs & pharma, fertilizers and sugar & Industrial alcohol, limit for cost audit are:-
 - Turnover from all type of products or services manufacturing or rendering should be ₹50 crore or more during preceding year. And
 - Turnover from products manufacturing or services rendering which covers under table A (regulated sector) or under table B (un-regulated sector) or both should be

Companies (Cost Records and Audit) Rules, 2014 (as amended)

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₹25crores or more during preceding year.

If both the above conditions are fulfilled by such regulated sector then cost Audit shall be applicable on the cost records of products or services covered under table A

- 2) or remaining 33 un-regulated sectors, limits far cost audit are as follows: -
- Turnover from all types of products or services manufacturing or rendering should be ₹ 100 crores or more during preceding year. And
 - Turnover from products manufacturing or service rendering which covers under table A (regulated sector) or under table B (und regulated sector) or both should be ₹35 crore or more during preceding year.

If both the above conditions are fulfilled by such non-regulated then the cost audit shall be applicable on the cost records of products or services under table B

- 3) If in case, products as services under table A or/ and table B fulfils all the four above conditions then cost audit shall apply on all cost records of products or services covered under table A and B

cases	Turnover from A products or services. (₹ A)	Turnover from table B products or services. (₹B)	Turnover from all other products or services (₹C)	Total no of table A & B products or services (₹A+B)	Total no of all products / services A+B+C (₹)	Applicability of: -	
						Cost records	Cost audit
1	6 CR	9 CR	13 CR	15 CR	28 CR	No	No
2	8 CR	8 CR	26 CR	16 CR	42CR	Yes	No
3	18 CR	8 CR	26 CR	26 CR	52 CR	Yes (A)	Yes (A)
4	18 CR	18 CR	28 CR	36 CR	64 CR	Yes (A)	Yes (A)
5	20 CR	25 CR	65 CR	45 CR	110 CR	Yes(A&B)	Yes (BOTH)
6	38 CR	0 CR	65 CR	38 CR	103 CR	Yes(A)	Yes (A)

- 4) Exception of applicability of cost Audit:

Cost audit will be exempted even if turnover limit is crossed, if the company falls in any of the following categories: -

Companies (Cost Records and Audit) Rules, 2014 (as amended)

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- Company is operated from SEZ.
- If revenue of company from export (in foreign exchange) Exceeds 75% of total revenue.
- Company engaged in generation of electricity for captive consumption.

Rule: 5 Maintenance of cost records:

Cost records in form no CRA-1 shall be maintained on a regular basis (i.e. monthly, quarterly or half-yearly or annually) for the calculation of: -

- Per unit cost
- Cost of sale
- Margin per product / services.

Rule: 6 Cost audit

- i. Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, to be filled by BOD within 30 days.
- ii. And company shall inform to C.G inform CRA-2 within 30 days from appointment of new cost auditor.

Application of cost Auditor:

- 1) Companies covered under the provision of the cost shall appoint a cost auditor within 180 days from the commencement of every F.Y.
- 2) Cost auditor shall give a written consent and a certification to the company after his appointment.
- 3) Such certificate contains following declaration.
 - The individual or firm or LLP is eligible for appointment under CWA Act, 1959 and companies Act 2013.
 - The purposed appointment is within the limits laid down under CWA Act, 1959.
 - The list of proceedings against the cost auditor related to professional misconduct as disclosed in the certificate is true or not.
- 4) Company shall inform to C.G. in form CRA-2 within 30 days from such appointment about the appointment of cost auditor.
- 5) Cost auditor shall submit cost audit report within 180 days prior from closure of such F.Y. to BOD in form no CRA-3
- 6) BOD may removed such cost auditor after passing board resolution at any time.
- 7) Any casual vacancy shall be filled by BOD within 50 days and inform to C.G about new cost auditor (in CRA2) appointed from the date of appointment, within another days.
- 8) Every company shall submit such cost report to C.G in form CRA-4 within 30 days of receipt of report from cost auditor.
- 9) If a company once covered under the provisions of cost records or cost audit then criteria of cost records or of cost audit shall be followed in subsequent exceed specified

Companies (Cost Records and Audit) Rules, 2014 (as amended)

BCCA

limit or not.

Annexures to the cost audit report (i.e. with CRA-3)

-Part A for both manufacturing and service sector.

Para	Content
1	General information of company like name, CIN, address etc.
2	General details of cost Auditor.
3	Cost accounting policy on material cost, depreciation etc.
4	Details of product produced as services rendered.

-Part B for manufacturing Sector.

Para	Content
1	Quantitative details of capacity
2	Abridged cost statement.
2A	Details of material consumed.
2B	Details of utility.
2C	Details f industry specific operating expenses.

Part C for service sector

Para	Content
1	Quantity information for each service.
2	Abridged cost statement for each service.
2A	Details of material consumed for services rendered.
2B	Details of utilities.
2C	Details of industry specific operation expenses.

-Part D For both manufacturing and service sector

Para	content
1	Products and services profitability statements.
2	Reconciliation statements b/w cost regards and financial records
3	Value addition and distribution of earnings.
4	Financial position and ratio analysis.
5	Related party transactions.
6	Reconciliation of indirect taxes.

Illustration 1.

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:

Companies (Cost Records and Audit) Rules, 2014 (as amended)

BCCA

(` In lakhs)

Particulars			
Net Sales	1,745	1,705	1,610
Raw Materials consumed	1,140	1,060	975
Direct Wages	35	32	27
Power and Fuel	30	27	24
Stores and Spares	6	5	4
Depreciation charged to production cost centres	16	15	13
Factory overheads:			
Salaries and wages	5	4	3
Depreciation	2	2	2
Rates and Taxes	1	1	1
Other overheads	6	5	4
Administrative overheads:			
Salaries and Wages	10	9	8
Rates and Taxes	2	2	2
Other overheads	162	154	148
Selling and distribution overheads:			
Salaries and Wages	7	6	5
Packing and Forwarding	6	6	5
Depreciation	1	1	1
Other overheads	124	118	108
Interest	85	74	68
Bonus and Gratuity	12	10	9
Gross Current Assets	840	724	640
Current Liabilities and Provisions	324	305	246

You are required to compute the following ratios as per requirement of Part D, Para 3 & 4 of the Annexure to Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for 3 years:

- (i) Operating Profit as percentage of Value Addition.
- (ii) Value Addition as percentage of Net Sales.
- (iii) Note: The computation should be based on EBDIT as Operating Profit.

Companies (Cost Records and Audit) Rules, 2014 (as amended)

Illustration 2

The following figures are obtained from the Cost Accounting Records of Sinjini Ltd. a single product manufacturing company:

Year ended 31st March	2022	2021
	(Amount in ` lakh)	
Net Sales	4,800	3,840
Other Income	300	200
Increase in Value of Stock of Finished Goods	20	10
Raw materials Consumed	1,760	1,440
Direct wages, Salaries, Bonus, Gratuity etc.	440	352
Power & Fuel	240	192
Stores and Spares	160	140
Cess and local Taxes	120	100
Other manufacturing Overheads	430	370
Administrative Overheads:		
Audit fees	36	30
Salaries & Commission to Directors	48	40
Other Overheads	260	220
Selling and Distribution Overheads:		
Salaries & Wages	36	30
Packing and forwarding	20	16
Other Overheads	250	200
Total Depreciation	120	120
Interest Charges:		
On Working Capital Loans from Bank	60	25
On Fixed Loans from IDBI	90	70
On Debentures	30	30
Provision for Taxes	316	200
Proposed Dividends	420	230

You are required to calculate the following parameters as stipulated PART-D, PARA-3 of the Annexure to Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended March 31, 2022 and March 31, 2021:

Companies (Cost Records and Audit) Rules, 2014 (as amended)

- (i) Value Addition
- (ii) Earnings available for Distribution
- (iii) Distribution of Earnings to the different claimants

Illustration 3

The following figures are obtained from the Cost Accounting Records of Vennela Ltd. :

Year ended 31st March	2022	2021
Particulars	(Amount in ` lakhs)	
Net Sales	7,120	5,700
Other Income	450	300
Export Incentives	80	60
Increase in Value of Stock of Finished Goods	30	15
Raw materials consumed	2,640	2,160
Direct wages, salaries, bonus, gratuity etc.	660	528
Power & Fuel	360	288
Stores and spares	240	210
Other manufacturing overheads	645	555
Administrative Overheads :		
Audit fees	54	45
Salaries & commission to directors	72	60
Other overheads	390	330
Selling and distribution overheads :		
Salaries & Wages	54	45
Packing and forwarding Other overheads	30	24
	375	300
Total depreciation	180	180
Interest Charges :		
On working capital loans from Bank	90	75
On fixed loans from IDBI	135	105
On Debentures	45	45
Tax paid including provisions	474	300
Dividend paid	630	345
Dividend Distribution Tax	110	60

You are required to calculate the following parameters as stipulated PART-D, PARA-3 of the

Companies (Cost Records and Audit) Rules, 2014 (as amended)

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Annexure to Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended March 31, 2022 and March 31, 2021:

- (i) Value addition
- (ii) Earning available for Distribution
- (iii) Distribution of Earning to the different claimants

RECONCILIATION

Illustration 4

In the Financial Accounts of Chemicals & Fertilizers Ltd. for the year ended March 31, 2022 the profit was 8,98,07,500. The profit as per Cost Accounting records for the same period was less. The following details are extracted from the accounting schedules and Cost Accounting records of the company.

	Financial Accounts ` '000	Cost Accounts ` '000
Opening: Semi Finished Goods	31700	35210
: Finished Goods	83220	78590
Closing: Semi Finished Goods	35260	39420
: Finished Goods	89320	80450
Urea & Transport subsidy	348	
Expenses on CSR	56	
Profit on sale of Fixed Assets	150	
Chemical used internally	382	365
Favourable Exch. Rate variation	294	
Post-retirement Medical grant	584	
Purchase Tax Refund	453	
Litigation Recovery-Prior year	125	

You are required to prepare a Reconciliation Statement and arrive at the Profit as per Cost Records for the year ended March 31, 2022.

Illustration 5

M/s H.K. Paino Company showed a net loss of Rs. 4,16,000 as per their financial accounts for the year ended 31st March, 2006. The cost accounts, however, disclosed a net loss of Rs. 3,28,000 for the same period. The following information was received as a result of scrutiny of the figures of both the sets of books.

Companies (Cost Records and Audit) Rules, 2014 (as amended)

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Particulars	Rs.
Factory overheads under recovered	6,000
Administration overheads over recovered	4,000
Depreciation charged in financial accounts	1,20,000
Depreciation recovered in costs	1,30,000
Interest on investment not included in costs	20,000
Income tax provided	1,20,000
Transfer fees (credit in financial books)	2,000
Stores adjustment (credit in financial books)	2,000

Prepare a reconciliation statement

Illustration 6

The following figures have been extracted from the Financial Accounts of a Manufacturing Firm for the first year of its operation: -

Particulars	Rs
	.
Direct Material Consumption	50,00,000
Direct Wages	30,00,000
Factory overheads	16,00,000
Administrative overheads	7,00,000
Selling overheads	9,60,000
Bad debts	80,000
Preliminary expenses (written off)	40,000
Legal Charges	10,000
Dividend Received	1,00,000
Interest on deposit received	20,000
Sales - 1,20,000 units	1,20,00,000
Closing Stock:	
Finished Goods 4,000 units	3,20,000
Work in progress	2,40,000

Companies (Cost Records and Audit) Rules, 2014 (as amended)

The cost accounts for the same period reveal that the material consumption was Rs. 56,00,000. Factory overheads recovered @ 20% on prime cost, Administration overheads is recovered at Rs. 6 per unit of production. Selling and Distribution overheads are recovered at Rs. 8 per unit sold.

Prepare the Profit and Loss Accounts both as per financial records and as per cost records. Reconcile the profits as per the two records.

Illustration 7

Modern Company Limited furnished the summary of Trading and Profit and Loss Account for the year ended 31st March, 2006 -

Particulars	Rs.	Particulars	Rs.
To Raw Material	1,39,600	By Sales (12,000 Units)	4,80,000
To Direct Wages	76,200	By Finished Stock (200 units)	8,000
To Production OHs	42,600	By Work in progress:	
To Administration OH	39,100	Materials 28,200	
To Selling & Dist. overheads	42,700	Wages 11,796	
To Goodwill w/off	2,501	Production OH 7,999	47,995
To Preliminary exp. written off	2,200		
To Dividend (Net)	3,000		
To Income Tax	4,100	By Interest on securities	6,000
To Net Profit	1,89,994		
Total	5,41,995	Total	5,41,995

The company manufactures a Standard Unit. Scrutiny of cost records for the same period show that -

- Production overheads have been allocated to the production at 20% on Prime Cost.
- Administration overheads have been charges at Rs. 3 per unit on units produced.
- Selling and Distribution expenses have been charged at Rs. 4 per unit on units sold.

You are required to prepare a statement of cost to work out profit as per Cost Accounts and to reconcile the same with that shown in the financial accounts.

Case 1: M/s. XYZ & Co. Ltd. furnishes the following information in regard to the immediately preceding Financial

Year:

Turnover of Table A Products under Rule 3 is ` 6 crore

Turnover of Table B Products under Rule 3 is ` 9 crore

Turnover of other products is ` 18 crore

Companies (Cost Records and Audit) Rules, 2014 (as amended)

Find out the applicability of:

- (a) Cost Records under Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)
- (b) Cost Audit under Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)

Case 2: M/s. ABC Ltd. furnishes the following information in regard to the immediately preceding Financial Year:

Turnover of Table A Products under Rule 3 is ` 7 crore

Turnover of Table B Products under Rule 3 is ` 8 crore

Turnover of other products is ` 24 crore

Find out the applicability of:

- (a) Cost Records under Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)
- (b) Cost Audit under Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)

Case 3: M/s. B. K. Pvt. Ltd. furnishes the following information in regard to the immediately preceding Financial Year:

Turnover of Table A Products under Rule 3 is ` 11 crore

Turnover of Table B Products under Rule 3 is ` 14 crore

Turnover of other products is ` 28 crore

Find out the applicability of :

- (a) Cost Records under Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)
- (b) Cost Audit under Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)

Case 4: M/s. Sun Enterprise Ltd. furnishes the following information in regard to the immediately preceding Financial Year:

Turnover of Table A Products under Rule 3 is ` 19 crore

Turnover of Table B Products under Rule 3 is ` 15 crore

Turnover of other products is ` 76 crore

Companies (Cost Records and Audit) Rules, 2014 (as amended)

BCCA

Find out the applicability of:

- (a) Cost Records under Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)
- (b) Cost Audit under Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)

Case 5: M/s. Alpha Pvt. Ltd. furnishes the following information in regard to the immediately preceding Financial

Year:

Turnover of Table A Products under Rule 3 is ` 20 crore

Turnover of Table B Products under Rule 3 is ` 22 crore

Turnover of other products is ` 63 crore

Find out the applicability of:

- (a) Cost Records under Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)
- (b) Cost Audit under Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 (as amended)

NON-REGULATED SECTOR

1. Machinery and mechanical appliances used in defense, space and atomic energy sectors excluding any ancillary item or items;
Explanation. - For the purposes of this sub-clause, any company which is engaged in any item or items supplied exclusively for use under this clause shall be deemed to be covered under these rules.
2. Turbo jets and turbo propellers;
3. Arms and ammunitions and Explosives
4. Propellant powders; prepared explosives (other than propellant powders); safety fuses; detonating fuses; percussion or detonating caps; igniters; electric detonators;
5. Radar apparatus, radio navigational aid apparatus and radio remote control apparatus;
6. Tanks and other armored fighting vehicles, motorized, whether or not fitted with weapons and parts of such vehicles, that are funded (investment made in the company) to the extent of ninety per cent or more by the Government or Government agencies
7. Port services of stevedoring, pilotage, hauling, mooring, re-mooring, hooking, measuring, loading and unloading services rendered for a port in relation to a vessel or goods regulated by the Tariff Authority for Major Ports under the Major Port Trusts Act, 1963 (38 of 1963);
8. Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered at the airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008);

9. Iron and Steel
10. Roads and other infrastructure projects corresponding to para No. (1) (a) as specified in Schedule VI of the Companies Act, 2013
11. Rubber and allied products being regulated by the Rubber Board constituted under the Rubber Act, 1947 (XXIV of 1947).
12. Coffee and tea;
13. Railway or tramway locomotives, rolling stock, railway or tramway fixtures and fittings, mechanical (including electro mechanical) traffic signaling equipment's of all kind;
14. Cement
15. Ores and mineral products
16. Mineral fuel (other than petroleum), mineral oils etc.
17. Base metals
18. Inorganic chemicals, organic or inorganic compounds of precious metals, rare-earth metals of radioactive elements or isotopes, and Organic Chemicals
19. Jute and jute products
20. Edible oil
21. Construction Industry as per para No. (5) (a) as specified in Schedule VI of the companies act
22. Health services, namely functioning as or running hospitals, diagnostic centres, clinical centers or test laboratories
23. Education services, other than such similar services falling under philanthropy or as part of social spend which do not form part of any business
24. Milk powder
25. Insecticides;
26. Plastics and polymers
27. Tires and tubes
28. Pulp and paper
29. Textiles
30. Glass
31. Other machinery and Mechanical Appliances
32. Electricals or electronic machinery;
33. Production, import and supply or trading of following medical devices, namely:
 - (i) Cardiac stents;
 - (ii) Drug eluting stents;
 - (iii) Catheters;
 - (iv) Intra ocular lenses;
 - (v) Bone cements;
 - (vi) Heart valves;
 - (vii) Orthopedic implants;
 - (viii) Internal prosthetic replacements;
 - (ix) Scalp vein set;
 - (x) Deep brain stimulator;

- (xi) Ventricular peripheral shod;
- (xii) Automatic palpable cardiac defibrillators;
- (xiii) Pacemaker (temporary and permanent);
- (xiv) Patent-ductus arteriosus, atrial septal defect and ventricular septal defect closure device;
- (xv) Cardiac re-synchronize therapy;
- (xvi) Urethra sinecure devices;
- (xvii) Sling male or female;
- (xviii) Prostate occlusion device; and
- (xix) Urethral stents;

Category B: Unregulated Sector-33 industries

1. Machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items (Inclusions: Any company which is engaged in any item or items supplied exclusively for use under this clause, shall be deemed to be covered under these rules)
2. Turbo jets and turbo propellers,
3. Arms, ammunitions and explosives;
4. Propellant powders; prepared explosives (other than propellant powders), safety fuses, detonating fuses, percussion or detonating caps; igniters; electric detonators;
5. Radar apparatus, radio navigational aid apparatus and radio remote control apparatus;
6. Tanks and other armoured fighting vehicles, motorised, whether or not fitted with weapons and parts of such vehicles, that are funded (investment made in the company) to the extent of ninety per cent, or more by the Government or Government agencies;
7. Port services of stevedoring, pilotage, hauling, mooring, re-mooring, hooking, measuring, loading and unloading services rendered by for a Port in relation to a vessel or goods regulated by the Tariff Authority for Major Ports under the Major Ports Trusts Act, 1963 (38 of 1963):
8. Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by at the airports [Exclusions all airports and aircraft operations belonging to or subject to the control of the Armed Forces or paramilitary Forces of the Union are excluded from the scope of these Rules)
9. Iron and Steel;
10. Roads and other infrastructure projects (It covers Roads, national highways, state highways, major district roads, other district roads and village roads, including toll roads, bridges, highways, road transport providers and other road-related services. Hence, every activity including construction and maintenance of the above projects are covered under the Rules)

11. Rubber and allied products
12. Coffee and tea;
13. Railway or tramway locomotives, rolling stock, railway or tramway fixtures and fittings. mechanical (including electro mechanical) traffic signalling equipment of all kind,
14. Cement;
15. Ores and Mineral products:
16. Mineral fuels (other than Petroleum), mineral oils etc.
17. Base metals;
18. Inorganic chemicals, organic or inorganic compounds of precious metals, rare-earth metals of radioactive elements or isotopes, and Organic Chemicals;
19. Jute and Jute Products,
20. Edible Oil:
21. Construction Industry (It covers Industrial, commercial and social development and maintenance, real estate development, including an industrial park or special economic zone contractors as well as sub-contractors)

FYK 1- The above category covers Industrial, commercial and social development and maintenance, real estate development, including an industrial park or special economic zone-contractors as well as sub-contractors Would the construction and sale of residential property like residential flat be covered in the rules?

The Technical cell (TC) of the Institute has clarified that this category covers Industrial, commercial and social development and maintenance, real estate development, including an industrial park or special economic zone. Hence, construction and sale of Residential Flats, which has not been covered under the para mentioned above, is not covered under the Rule 3.

FYK 2-A private company is into the business of modification as well as construction business of airport. Airport Authority of India has awarded contract to them titled "Modification Expansion of existing Integrated Terminal Building". Whether to group it in Construction Industry or Roads & Other Infrastructure Projects?

The TC had clarified that the above category covers Development & Maintenance of Commercial and Industrial projects. In the instant case, the project / contract is for development of Commercial Project and hence it will be covered under Table B, Sr No. 21- Construction Industry. Nikkhil Gupta@

22. Health services, namely functioning as or running hospitals, diagnostic centres, clinical centres or test laboratories; (Exclusions-1) companies running hospitals exclusively for its own employees, provided if such hospitals are not providing health services to outsiders also in addition to its own employees on chargeable basis and 2) companies engaged in running of Beauty parlours/beauty treatment]

COST ACCOUNTING STANDARDS AND GACAP

Meaning of CAS:

1. CAS are **guidelines for the companies.**
 - that specify the cost accounting treatment for various cost elements,
 - minimum disclosure requirements and
 - ensure the comparability, consistency, and completeness of cost records.
2. CAS are **designed to achieve**
 - uniformity and consistency
 - in cost accounting principles and practices

Who are empowered to design, CAS:

The Institute of Cost Accountants of India,

- i. **recognizing the need** for structured approach to the measurement of cost in manufacture or service sector and
- ii. to provide guidance to the user organizations, government bodies, regulators, research agencies and academic institutions to achieve uniformity and consistency in classification, measurement and assignment of cost to product and services,
- iii. has constituted Cost Accounting Standards Board (CASB) with the objective of formulating the Cost Accounting Standards.
- iv. Keeping in view latest legal and contemporary developments, CASB develops Cost Accounting Standards.
- v. CASB develops CAS and issued by council of Institute of Cost Accountants of India.

Utilizes of Cost Accounting standards

Cost Accounting standards aimed to provide the following advantages.

- i. To provide a structured approach to measurement of costs in manufacturing process or service industry.
- ii. To integrate, harmonize, and standardize cost accounting principles and practices
- iii. To provide guidance to users to achieve uniformity and consistency in classification, measurement, assignment, and allocation of costs to products and services
- iv. To arrive at the basis of computing the cost of product, activity, or service where required by legal or regulatory bodies
- v. To enable practicing members to make use of Cost Accounting Standards in the attestation of General-Purpose Cost statements; and
- vi. To assist in clear and uniform understanding of all the related issues by various user organizations, Government Bodies, regulators, research agencies, and academic institutions

Structure of CAS

A Cost Accounting Standard designed by Cost Accounting Standard Board broadly consists

Overview of Cost Accounting Standards and GACAP

of the following phases.

- Introduction,
- Objectives of issuing standards,
- Scope of standard,
- Definitions and explanations of the terms used in the standard
- Principles of Measurement, Assignment of Cost,
- Presentation and
- Disclosure

List of Cost Accounting Standards:

CAS NO	Title of Cost Accounting Standard
CAS 1	Classification of Cost
CAS 2	Capacity Determination
CAS 3	Production & Operation overheads
CAS 4	Cost of Production/Acquisition/ Supply of Goods/ Provision of Service
CAS 5	Average (equalized) Cost of Transportation
CAS 6	Material Cost
CAS 7	Employee Cost
CAS 8	Cost of Utilities
CAS 9	Packing Material cost
CAS 10	Direct Expenses
CAS 11	Administrative Overheads
CAS 12	Repairs & Maintenance
CAS 13	Cost of Service cost center
CAS 14	Pollution Control Cost
CAS 15	Selling & Distribution Overheads
CAS 16	Depreciation & Amortization
CAS 17	Interest & Financing Charges
CAS 18	Research & Development Costs
CAS 19	Joint Costs
CAS 20	Royalty & technical Know How Fee
CAS 21	Quality Control
CAS 22	Manufacturing Cost

Overview of Cost Accounting Standards and GACAP

CAS 23	Overburden Removal Cost
CAS 24	Treatment of revenue in cost statements

CAS 01 CLASSIFICATION OF COST

I. Introduction:

- This standard deals with the principles of Classification of Cost for determining the cost of product or service.
- Meaning of classification: Classification of cost is the process of grouping the components of cost under a common designation on the basis of similarities, attributes or relations.

II. Objective: The objective of this standard is

- to bring uniformity and consistency
- in the principles of Classification of Cost

III. Scope:

- This standard shall be applied to cost statements.
- which require classification, presentation and disclosure of cost including those requiring attestation.
- for disclosure and presentation in the cost statements of a product or service.

IV. Principles of Classification of Costs:

- **Base for classification:** Costs shall be classified by the **process of grouping the components** of cost under a common designation on the basis of
 - similarities of nature,
 - attributes or relations.
 - Items grouped together under common heads shall be further classified according to their fundamental differences.
 - Scheme of classification shall be such that every item of cost is classified.

V. Classification of Cost:

- a. **based on Nature of Expense:** Cost can be classified into the following three types based on their Nature.

- **Material Cost:**

- ✓ Material cost is the cost of basic substances which are pre-requisite for the purpose of production of a product or a service.
- ✓ It includes cost of materials, freight inwards, taxes & duties, insurance etc. which are directly attributable to acquisition, but excluding the trade discounts, duty drawbacks and refunds on account of excise duty and GST.

- **Labor Cost:**

- ✓ It means the payment made to the employees, permanent or temporary for their services.
- ✓ Labor cost includes salaries and wages paid to permanent employees, temporary employees and also to the employees of the contractor.

- ✓ The term Salaries and Wages include all the benefits like provident fund, gratuity, ESI, overtime, incentives etc.
- **Expenses:**
 - ✓ Expenses are other than material cost or labor cost which are involved in an activity.
 - ✓ For example, Cost of utilities, bought out services, Job processing charges etc.
- b. **based on traceability to a cost object:** Cost can be classified into the following two types based on their Object.
 - ❖ **Direct Cost:**
 - ✓ If a cost can be assigned to a cost object in an economically feasible way, it shall be termed as direct to that cost object.
 - ✓ $\text{Direct cost} = \text{Direct Material Cost} + \text{Direct Labor Cost} + \text{Direct expenses}.$
 - ❖ **Indirect Cost:**
 - ✓ If any Cost which cannot be assigned to a cost object in an economically feasible way, it shall be considered as Indirect Cost to such cost object.
 - ✓ $\text{Indirect Cost} = \text{Indirect material} + \text{Indirect Labor} + \text{Indirect Expenses}$
 - ❖ **based on FUNCTION:** Cost shall be classified into the following major functions
 - ✓ **Production Cost** - Total cost incurred on conversion of raw material into final production. It comprises of prime cost plus production overheads.
 - ✓ **Administration Cost** - Total cost incurred on formulation, direction, implementation, periodical review and control of various policies.
 - ✓ **Selling Cost** - cost incurred to create the demand and securing an order for the final product or service.
 - ✓ **Distribution cost** - organization for making the product available to the customers at his location.
 - ✓ **Research cost** - cost of searching for a new or improved product, new application of materials a new or improved method of production
 - ✓ **Development Cost** - cost of the process which begins with implementation of the decision to produce a new or improved product, method and ends with the commencement of formal production of that product
 - ❖ **Based on behavior:** Costs are classified based on behavior as
 - ✓ **Fixed cost** - Any Cost which will not vary in direct proportion to changes in volume of production.
 - ✓ **Variable Cost** - Any cost which will vary in direct proportion to the changes in the volume of production.
 - ✓ **Semi-variable cost** - Any cost which comprises characteristics of both fixed cost and variable cost.

- ❖ **Based on production or operation process:** Cost shall be classified into the following types
 - **Batch Cost** - Aggregate cost related to a cost unit which consist of a group of similar articles or services which maintain its identity throughout one or more stages of production operation.
 - **Process Cost**-cost of production or operation process where goods are produced, or services rendered from a sequence of continuous or repetitive operations or processes during a period.
 - **Operation Cost** - cost a specific operation involved in production of goods or rendering of services.
 - **Contract Cost**-cost of a contract agreed upon between the contracted and the contractor.
 - **Joint Costs** - costs of common resources used for producing two or more products or rendering two or more services simultaneously.

VI. Presentation:

- Cost items in the cost statement shall be presented on basis of relevant classification
- Classification of cost items shall be followed consistently from period to period

VII. Disclosure:

- **Changes in classification of cost:** Any change in classification of cost shall be made only if
 - ✓ It is required by law or
 - ✓ For compliance with a Cost Accounting Standard or
 - ✓ Such change would result in a more appropriate preparation or presentation of cost statements of an entity.
- **Changes having material effect:**
 - ✓ Any change in classification of cost which has a material effect on the cost of the product shall be disclosed in the cost statements.
 - ✓ Where the effect of such change is not ascertainable wholly or partly, such fact shall be indicated in the cost statement.

CAS 02-CAPACITY DETERMINATION

i. Introduction:

- These standard deals with the principles and methods of determining the capacity of an entity.
- for ascertainment of the cost of product or service, and
- the presentation and disclosure in cost statements.

ii. Objective

- The objective of this standard is to bring uniformity and consistency in the principles and methods of determination of capacity with reasonable accuracy.
- The standard is to help the management to identify the bottlenecks, imbalances and idle capacity for effective use of various resources.
- The standard is to help in proper allocation, apportionment and absorption of cost

iii. Scope

- This standard shall be applied to the cost statements, including those requiring attestation,
- which require determination of capacity for assignment of overheads

iv. Definitions:

- **Abnormal Idle Capacity:** It is the difference between normal capacity and actual capacity utilization.
- **Actual capacity utilization:** It is measured in terms of volume of production achieved or service provided as a percentage of installed capacity.
- **Installed capacity:** It is the maximum capacity of producing goods or providing services, determined based on technical specification or technical evaluation.
- **Normal Capacity:**
 - a. It is the volume of production or services achieved or achievable.
 - b. on an average over a period under normal circumstances
 - c. taking into account the reduction in capacity resulting from planned maintenance.
- **Normal Idle Capacity:** It is the difference between installed and normal capacity.
- **Practical or Achievable Capacity** - is the maximum productive capacity of a plant reduced by the predictable and unavoidable factors of interruption pertaining to internal causes like preventive maintenance, repairs, set ups, normal delays, weekly off days and holidays etc.

v. Determination of Capacity:

- Capacity shall be determined in terms of **units of production or services or equivalent machine or man hours**.
- Determination of Installed capacity:
 - ✓ It should be determined by taking into consideration the following factors.
 - Manufacturers' Technical specifications or technical evaluation
 - Capacities of individual or interrelated production centers.
 - Operational constraints / capacity of critical machines.
 - Number of shifts or machine hours or man hours.
 - Any other factor which is having impact on installed capacity
 - ✓ Installed capacity shall be reassessed in case of any change due to
 - addition,
 - deletion.
 - modification or
 - for any other reason from the date of such change
 - ✓ **Determination of Practical Capacity:** It is determined after the following suitable adjustments to the Installed Capacity
 - Time lost due to scheduled preventive or planned maintenance
 - Number of shifts or machine hours or man hours
 - Holidays, normal shut down days, normal idle time
 - Normal time lost in batch change over

- ✓ **Determination of Normal Capacity:**
 - Normal capacity is determined based on the productive capacity achieved over a period of time, say average of three normal years out of preceding five years or expected to be achieved over a period of time, say next three to five years.
 - This capacity is determined after adjustment of external factors with practical capacity.
 - Normal capacity of production process involved in the production of a product or the productive capacity of the plant as a whole should be taken into account to arrive at normal capacity for a product or plant, as the case may be.
 - The periods influenced by abnormalities should be excluded for this purpose.
- ✓ **Presentation:**
 - Cost Statements shall present Installed capacity, normal capacity and actual production of goods or services provided, in absolute terms.
 - Actual Capacity utilization shall be presented as a percentage of installed capacity.
- ✓ **Disclosures:**
 - The cost statements shall disclose the following:
 - Basis for arriving at different types of capacity.
 - Changes in the installed capacity or normal capacity with reason thereof
 - Capacity enhanced through outsourcing.
 - Capacity outsourced to others.
 - Details of actual production of goods or services provided.
 - ❖ Self-Manufactured goods or services provided through in- house facility
 - ❖ Goods Produced or services provided through outsourcing.
 - Reasons for low-capacity utilization
 - Abnormal cost due to under-utilization of capacity
 - Disclosures 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 as a separate schedule.

CAS 03-PRODUCTION & OPERATION OVERHEADS

❖ Introduction:

- This standard deals with the principles and methods of classification measurement and assignment of Production or Operation Overheads,
- for determination of the cost of goods produced or services provided and
- for the presentation and disclosure in cost statements

❖ Objective:

Overview of Cost Accounting Standards and GACAP

- The objective is to bring uniformity and consistency.
- in the principles and methods of
- determining the Production or Operation Overheads with reasonable accuracy
- ❖ **Scope:**
 - Shall be applied to cost statements,
 - which require classification, measurement, assignment, presentation and
 - of Production or Operation Overheads including those requiring attestation disclosure
- ❖ **Definitions:**
 - **Abnormal cost:**
 - An unusual or atypical cost
 - whose occurrence is usually irregular and unexpected or
 - due to some abnormal situation of the production or operation
 - **Absorption of Production OH:**
 - Assigning of Production or Operation Overheads
 - to cost objects
 - by means of appropriate absorption rate.
 - **Production or Operation Overheads:**
 - All categories of Indirect costs involved in the production of a product or in providing service.
 - it Production OH includes administration overheads relating to production or rendering of services.
 - **Standard Cost:**
 - It is predetermined cost of a product or service
 - Based on technical specifications and
 - Efficient operating conditions
- ❖ **Principles of Measurement:**
 - **Procured resources at invoice value:**
 - Production or Operation Overheads representing procurement of resources shall be determined at invoice or agreed price.
 - Invoice price includes the following.
 - duties and taxes, and
 - other expenditure directly attributable thereto
 - Invoice price excludes the following.
 - Discounts (other than cash discounts)
 - Refundable taxes and duties
 - **Other Production OH at Cost:**
 - i. Other POH shall be determined on the basis of cost incurred.
 - ii. For example,
 - machinery spare fabricated internally
 - repair job carried out internally etc.
 - Also consider common points for all CAS provided in note below.

- **Proper records** shall be maintained for various items of indirect expenses comprising overheads pertaining to goods or services under reference. These expenses shall be analyzed, classified and grouped according to functions.
- ❖ **Assignment of POH:**
 - POH cost which can be traced directly to a cost object shall be directly assigned to such cost object.
 - POH Cost which cannot be traced directly to a cost object shall be assigned using any one of the following principles.
 - Cause and Effect - Cause is the process or operation or activity and effect is the incurrance of cost.
 - Benefits received - Production Overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.
 - Facilities created on a standby or ready to serve basis - cost shall be assigned on the basis of expected benefits instead of actual.
- ❖ **Absorption of Production OH:**
 - **Variable POI**- absorbed to products or services-based production.
 - **Fixed POII** - absorbed based on the normal capacity.
- ❖ **Presentation:**
 - Production or Operation Overheads shall be presented as separate cost headings.
 - If POH material, then the following details should be provided.
 - Element wise and
 - behavior wise
 - Under or over absorbed POII should be presented in the cost reconciliation statement.
- ❖ **Disclosures:** The cost statements shall disclose the following
 - The **basis of assignment** of Production or Operation Overheads to the cost objects
 - Production Overheads **incurred in foreign exchange**.
 - Production Overheads relating to resources received from or supplied to related.
 - Any **Subsidy, Grant, Incentive** or any amount of similar nature received, or receivable reduced from Production Overheads.
 - **Credits or recoveries** relating to the Production or Operation Overheads
 - Any **abnormal cost** not forming part of the Production Overheads
 - Any **unabsorbed** Production or Operation Overheads
- ❖ Disclosures 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 as a separate schedule.
- ❖ Any **change in the cost accounting principles** and methods applied for the measurement and assignment of the Production or Operation Overheads during the period covered by the cost statement.
 - ✓ Which has a material effect on the Production Overheads shall be disclosed.
 - ✓ Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

Note 01: Common points for all CAS:

- **Abnormal Cost:** Any abnormal cost where it is material and quantifiable shall not form part of the cost.
- **Imputed Cost:** It shall not include imputed cost i.e. any cost which does not involve cash outlay.
- **Government Grants:** Any subsidy, Grant, Incentive or amount of similar nature received or receivable with respect to specific cost element shall be reduced for ascertainment of the cost of the cost object.
- **Penalties:** Fines, penalties, damages and similar levies paid or payable to statutory authorities or other third parties shall not form part of the cost.
- **Credits or recovery:**
 - Credits or recoveries relating to the relevant cost element is material and quantifiable shall be deducted from relevant element cost to arrive net cost.
 - If recovery exceeds the relevant cost element, the balance recovery shall be treated as other income.
- **Change In Cost Accounting Policy:** Any change in the cost accounting principles applied for the measurement of the cost element shall be made only,
 - If it is required by law or
 - for compliance with the requirements of a cost accounting standard, or
 - If change would result in a more appropriate preparation or presentation of cost statements of an entity.

CAS 01. Cost of production in case of captive consumption

1. Introduction

- CAS 04 was issued to specify the principles for determination of cost of production for valuation of goods meant for captive consumption.
- As per Rule 30 of CGST rules-2017, value of captively consumed goods shall be 110% percent of the cost of production or the cost of acquisition of such goods or the cost of provision of such services determined as per CAS 04.
- This Standard deals with the
 - ✓ principles and methods of classification, measurement and assignment for
 - ✓ the determination of cost of production or acquisition or supply of goods or provision of services
 - ✓ as required under the provisions of GST Act/Rules

2. Objective:

- is to bring uniformity and consistency in the principles and methods
- of determining the cost of production or acquisition or
- supply of goods or provision of services as required
- under the provisions of GST Acts/Rules.

3. Scope: This standard should be applied to cost statements which require classification, measurement, assignment, presentation, and disclosure of related costs for determination of the following under the relevant provisions of GST Acts/Rules

- Determination of cost of production or acquisition of goods
- Determination of cost of supply of goods
- Determination of cost of provision/supply of services; and
- Determination of value of supply of goods or services as per open market value or as per goods or services of like kind and quality.

4. Definitions:

- **Administrative Overheads:** Cost of activities relating to general management and administration of an entity.
- **Amortization:** Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.
- **Cost of Purchase/Acquisition:**
 - i. The costs of purchase/ acquisition of Goods comprise the purchase price, Import duties, other taxes, transport, handling, storage and other costs directly attributable to the acquisition of goods and services.
 - ii. Excludes trade discounts, rebate, refundable duties and taxes.
- **Cost of production:**
 - a. Cost of production of a product consists of
 - ✓ materials consumed.
 - ✓ Direct Wages and Salaries,
 - ✓ direct expenses.
 - ✓ works overheads.
 - ✓ quality control costs. research and
 - ✓ development costs, packing costs.
 - ✓ administrative overheads relating to production.
 - b. Adjustment for stock of Work-in-progress, finished goods, recoveries for sales of scrap, wastages etc. shall be made in calculation of cost of production.
- **Cost of Provision of Service:** It consists of
 - ✓ cost of materials consumed,
 - ✓ direct employee costs,
 - ✓ direct expenses.
 - ✓ quality control costs,
 - ✓ research and development costs,
 - ✓ operation overheads and
 - ✓ administrative overheads relating to provision of services
- **Development Cost:**
 - ✓ Development cost is the cost for application of research findings or other knowledge to a plan or
 - ✓ design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.
- **Joint Costs:** Joint costs are the cost of common resources used to produce two or

more products or services simultaneously.

- **Joint Product:**

- ✓ Products or services that are produced simultaneously, by the same process,
- ✓ identifiable at the end of the process and recognized as main products or services having sufficient value.

5. Principles of Measurement:

- a. Cost of production or acquisition of goods or provision of services shall be **measured for each type of goods or services** separately.
- b. Cost of production or acquisition or supply of **each type of goods** shall be
 - The aggregate of **direct and indirect costs**
 - Relating to the production or acquisition or supply activity of those goods.
- c. Cost of provision of **each type of service** shall be
 - The aggregate of direct and indirect cost
 - relating to that service activity.
- d. Material cost shall be measured separately for each type of material, that is.
 - for indigenous material,
 - imported material,
 - bought out components,
 - process materials,
 - self-manufactured items, and
 - accessories for each type of goods or services
- e. The **material cost of normal scrap/defectives**
 - Which are rejects shall be included in the material cost of goods produced or services provided.
 - The material cost of actual scrap/ defectives, not exceeding the normal quantity shall be adjusted in the material cost of good production.
 - The realized or realizable value of scrap or waste shall be deducted for determination of cost of production or acquisition of goods or provision of services.
 - Material Cost of abnormal scrap/defectives should not be included in material cost but treated as loss after deducting the realizable value of such scrap/defectives.
 - Employee Cost for each type of goods or services shall be measured separately.
 - The cost of utilities consumed for the production or acquisition, or supply of each type of goods or provision of services shall be measured for each type of utility separately i.e. power, electricity, water, steam & gas.
 - Cost of packing material used for the production or acquisition, or supply of goods or provision of services shall be measured for each type of goods or services separately.
- f. Direct Expenses for the production or acquisition or supply of goods or provision of services shall be measured for each type of goods or services separately.
- g. High value spare shall be recognized as property, plant and equipment when they meet the definition of property, plant and equipment and depreciated accordingly. Otherwise,

such items are classified as inventory and recognized in cost as and when they are consumed.

- h. Repair and maintenance cost for the production or acquisition or supply of goods or provision of services shall be measured for each type of goods or services separately.
- i. Depreciation and Amortization cost for the production or acquisition or supply of goods or provision of services shall be measured for each type of goods or services separately
- j. Research & Development cost for the production or acquisition or supply of goods or provision of services shall be measured for each type of goods or services separately
- k. Cost incurred for the production or acquisition or supply of goods or provision of services after split-off point shall be measured for each type of Joint/By-Product or service for the resources consumed
- l. Royalty and Technical Know-how Fee for production or acquisition or supply of goods or provision of services paid or incurred in lump-sum or which are in the nature of 'one-time' payment, shall be amortized on the basis of the estimated output or benefit to be derived from the related Technical Knowhow
- m. Royalty paid as a consideration for use of asset or on technology transfer, in any form, will form part of cost, however royalty paid on brand usage shall not form part of cost of production
- n. Quality Control cost incurred in-house for the production or acquisition or supply of goods or provision of services shall be the aggregate of the cost of resources used in the Quality Control activities in relation to each type of goods or service.
- o. Production or Operation Overheads representing procurement of resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts; taxes and duties refundable or to be credited as input tax credit.
- p. Any abnormal cost, where it is material and quantifiable, shall not form part of the cost of production or acquisition or supply of goods or provision of service.
- q. Interest and other Finance costs shall not form part of cost of production or acquisition of goods or provision of services
- r. Impairment loss on assets shall not form part of cost of production or acquisition or supply of goods or provision of services.
- s. Cost of production or acquisition or supply of goods or provision of services shall include cost of inputs received free of cost or at concessional value, net of input tax credit, from the recipient of goods or services and amortization cost of free tools, pattern, dies, drawings, blue prints, technical maps, charts, engineering, development, art work, design work, plans, sketches, and the like necessary for the production or acquisition or supply of goods or provision of services.
- t. The cost of production or acquisition or supply of goods or provision of services shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost

6. Assignment of Cost:

- a. Cost of production or acquisition or supply of goods or provision of services shall be

determined on 'normal cost' basis. The abnormal cost of various cost elements should be ignored.

- b. The cost which can be traced directly to each type of goods or services shall be directly assigned.
- c. The cost which cannot be traced directly to each type of goods or services shall be directly assigned:
 - **Cause and Effect** - Cause is the process or operation or activity and effect is the incurrance of cost.
 - **Benefits received** - to be apportioned to various cost objects in proportion to the benefits received by them.
- d. **Absorption of production OH:**
 - **Variable OH**-based on actual production
 - **Fixed OH** - based on Normal capacity or actual capacity whichever is higher.
- e. **Joint products and by-products:**
 - i. **Joint products** - Joint cost should be apportioned on a rational equitable, and consistent basis which are provided as below:
 - physical unit method
 - equivalent cost
 - net realizable value at split off point
 - ii. **By-Products**- net realizable value of by-products is credited to the manufacturing cost of the main product.
 - iii. **Joint services**-Joint cost should be allocated between the services on a rational, equitable, and consistent basis.
- f. Miscellaneous Income resulting from the production process should be reduced from the total cost of production.

7. Presentation:

- Cost Statements should be prepared as per the applicable formats and compliance with Rules, applicable CAS, and GAAP issued by the Institute.
- **If fair cost is not determinable:**
 - ✓ If it is not possible to determine true and fair cost of goods or services at the time of supply of such goods or services or both.
 - ✓ the company should compute the cost on the basis of estimates and the Cost Accountant may issue a provisional Cost certificate on such basis.
 - ✓ A final certificate shall be issued after costs are finalized in case of any variations.
 - ✓ The value of goods or services, the supplier shall issue a Debit or Note as per provisions of section 34 of the CGST Act
- **Periodicity of issue and signing of certified cost statements:**
 - ✓ In case of registered person, whose aggregate turnover in the preceding financial year
 - i. Did not exceed the limits Specified in U/Sec 10 (1) of CGST Act 2017-Certified Cost Statement shall be issued for a **6-month period**.

- ii. Exceeds the limits Specified U/sec 10(1) of CGST Act 2017-Certified Cost Statement shall be issued on **quarterly basis**.
 - ✓ Certified Cost Statement shall also be issued for the **completed financial year**, annually based on audited accounts **on or before 31st December** of the next financial year
 - **Signing of cost statements:** The cost statements shall be prepared by the Management and authenticated & signed by
 - ✓ any Key Management Personnel in case of company,
 - ✓ partner in case of partnership firm and
 - ✓ proprietor in case of proprietary firm e.
 - **Certification by CA:** The statement shall be certified by a Cost Accountant in practice.
8. **Disclosures:**
- a. **Only if material:** Disclosure shall be made only where material, significant, and quantifiable.
 - b. **Changes in Accounting principles:**
 - If there is any change in cost accounting principles and practices during the period under review
 - which may materially affect the cost of production or acquisition of goods or provision services in terms of comparability with previous period(s).
 - the same shall be disclosed.
 - c. **Non-Availability of stock levels:**
 - If opening stock and closing stock of work-in-progress
 - are not readily available for certification purpose,
 - the same should be disclosed
 - d. **Facts with material impact:** Any fact which may have material impact on the costs ascertained should be disclosed.

CAS OF DETERMINATION OF AVERAGE (EQUALIZED) COST OF TRANSPORTATION

1. Introduction:

- Transportation cost is an important element of cost for procurement of materials for production and for distribution of product for sale.
- Therefore, Cost Accounting Records should present transportation cost separately from the other cost of inward materials or cost of sales of finished goods.

2. Objective:

- a. To bring uniformity in the application of principles and methods used in the determination of averaged/ equalized transportation cost.
- b. To prescribe the system to be followed
 - for maintenance of records for collection of cost of transportation,
 - its allocation/apportionment to cost centers, locations or products
- c. To provide transparency in the determination of cost of transportation

3. **Scope:** It should be applied for calculation of cost of transportation required under any statute or regulations or for any other purpose
4. **Definitions**
 - i. **Transportation Cost:** It comprises of the
 - Cost of freight,
 - Cartage.
 - Transit insurance,
 - Cost of operating fleet and
 - Other incidental charges
 - whether incurred internally or to an outside agency for paid transportation of goods
 - but does not include detention and demurrage charges.
 - ii. **Inward Transportation Cost-**Refers to transportation expenses incurred in connection with materials /goods received at factory or place of use or sale/removal.
 - iii. **Outward Transportation Cost-**Refers to transportation expenses incurred in connection with the sale or delivery of materials or goods from factory or depot or any other place from where goods are sold /removed.
 - iv. **Freight-**It is the charges paid or payable for transporting materials/ goods from one location to another.
 - v. **Cartage** - It is the expenses incurred for movement of goods covering short distance for further transportation for delivery to customer or storage.
 - vi. **Transit insurance-** It is premium to be paid to cover the risk of loss /damage to the goods in transit.
 - vii. **Equalized transportation cost-** It is average transportation cost during a specific cost period.
5. **Maintenance of records for ascertaining Transportation Cost**
 - **Records by element:** Proper records shall be maintained for recording the actual cost of transportation showing **each element of cost** like,
 - ✓ Freight, Cartage, Transit insurance and others after adjustment for recovery of transportation cost.
 - **Records for own fleet:**
 - ✓ If a manufacturer having his own transport fleet,
 - ✓ Proper records shall be maintained to determine the actual operating cost of vehicles

showing details of various elements of cost, like

 - Salaries and wages of driver,
 - cleaners and others,
 - cost of fuel,
 - lubricant grease,
 - amortized cost of tyres and battery.
 - repairs and maintenance,

- depreciation of the vehicles,
 - distance covered and trips made,
 - goods hauled and transported to the depot.
- **Records for Hired Fleet:** If fleet is hired, then with respect to hire charges of fleet the following records should be maintained by showing the following information.
 - ✓ Date of dispatch,
 - ✓ type of transport used,
 - ✓ description of the goods,
 - ✓ destination of buyer,
 - ✓ name of consignee
 - ✓ challan number,
 - ✓ quantity of goods in terms of weight or volume, distance involved amount paid and other related details.
- **Separate Records:** Separate records should maintain for the following
 - ✓ Inward transportation Cost
 - ✓ Outward Transportation Cost
 - ✓ Transport cost from factory to depot
 - ✓ Transport cost from depot to other place
 - ✓ Transport cost of materials to job workers places and back
 - ✓ transport cost of goods for trading activities.
 - ✓ Transport cost directly chargeable to specific products
 - ✓ Basis for apportionment of common transport cost L.e. both own fleet and hired fleet
 - ✓ Transportation cost for exempted goods, excisable goods cleared for export.
 - ✓ Transport cost by mode of transport like road, ship, air etc.
- **Treatment of cost**
 - ✓ **Inward transportation cost**-included in the cost of materials procured.
 - ✓ **Outward transportation cost** - included in the cost of sales of various products apportioned on suitable basis.
 - ✓ **Basis for apportionment of outwards transport cost:** Any one of the basis can be selected by the entity for apportionment but the same shall be applied consistently
 - Weight
 - Volume of goods
 - Tone
 - Unit/Equivalent unit
 - Value of goods
 - Percentage of usage of space
 - ✓ **Average transport cost** - Distance should be considered while calculating weighted average transport cost.
 - ✓ **Abnormal and Non-recurring cost:**

- It shall not be a part of transportation cost.
- For examples Penalty, detention charges, demurrage and abnormal break down cost
- **Cost Sheet**
 - For each type of transportation cost separate cost sheet should be prepared to facilitate the entity to calculate average transport cost.
 - Records maintained by the entity should facilitate the preparation of such cost sheet.

CAS 06 – MATERIAL COST

1. Introduction:

- a. It deals with principles and methods of determining the Material Cost.
- b. Materials includes the following:
 - i. raw materials
 - ii. process materials
 - iii. additives
 - iv. manufactured/bought out components
 - v. sub-assemblies
 - vi. accessories,
 - vii. semi-finished goods
 - viii. consumable
 - ix. stores, spares and
 - x. other indirect materials
- c. **Non-Applicability:** The principles laid down in the standard does not apply for packing materials.
- d. The following aspects were covered under this standard:
 - i. Valuation of receipt of materials
 - ii. Valuation of issue of materials
 - ii. Objective:
 - iii. Assignment of material cost

2. Objective:

- is to bring uniformity and consistency
- in the principles and methods of
- determining the material cost with reasonable accuracy

3. Scope:

- This standard should be applied to cost statements
- which require classification, measurement, assignment, presentation and disclosure of material costs
- including those requiring attestation.

4. Definitions:

- **Defectives:**
 - i. Defectives refers to Materials, products or intermediate products that do not meet quality standards.

- ii. Defectives includes reworks or rejects
- iii. **Reworks:** Defective articles with a possibility of converting into quality products by further processing by introducing additional material, labour or expenses.
- iv. **Rejects:** Defective articles with no possibility of eliminating such quality defect by further processing.
 - **Direct Materials:** materials which can be attributed to a cost object in an economically feasible way.
 - **Indirect Materials:** Materials which cannot be directly attributed to particular cost object.
 - **Property, plant and equipment:**
 - tangible assets which are held for use in the production of goods or supply of services, for rental to others, for administrative, selling or distribution purposes; and
 - are expected to be used during more than one accounting period.
 - **Scrap:**
 - Discarded material having no or negligible value and
 - which is usually either disposed off without further treatment.
 - **Waste.**
 - Material lost during production or storage and discarded material.
 - which may or may not have any value.
 - **Spoilage:**
 - Production that does not meet the quality requirements or specifications and cannot be rectified economically.
 - Generally sold at a price which are substantially lower than normal selling prices of quality product-Second sales or clearance sales.

5. Measurement Principles of Material Cost:

a. Valuation of Receipt of Materials:

- i. **Purchased materials:** The following items are to be included for the purpose of Valuation of Receipt of materials.
 - Purchase price
 - Duties and taxes
 - Freight inwards
 - Insurance
 - Other expenditures directly attributable to procurement and can be quantified with reasonable accuracy at the time of procurement.

The following are to be excluded for the purpose of determining valuation of receipt of materials.

- Trade discounts.
- Rebates.
- Refundable taxes and duties like duty drawback, Input tax credit of GST etc.

- ii. **Self-manufactured materials, components and sub-assemblies:**
 - ✓ shall be valued including
 - a. direct material cost,
 - b. direct employee cost,
 - c. direct expenses,
 - d. factory overheads,
 - e. share of administrative overheads production relating to production.
 - f. but excluding share of other administrative overheads, finance cost and marketing overheads.
- iii. **Spare parts and standby equipment:**
 - If they meet recognition criteria of PPE, then capitalized and depreciated.
 - If not met recognition criteria of PPE, shown as inventory and included in the cost when they are consumed.
- iv. **Treatment of Normal losses of materials:**
 - Normal loss or spoilage or shrinkage or evaporation or gain due to elongation before receipt of material.
 - Value of normal loss as reduced by amount received from others should be included in the value of goods materials received.
- v. **Imported Materials:** These materials should be converted into INR using the **exchange rate prevailing on the date of transaction** or importation.
- vi. **Standard Cost:** If the entity follows the standard cost system.
 - Price variance is includable item
 - Usage or volume variance is excludable item.
- vii. **Exclusions in valuation of receipt of materials:**
 - Finance costs.
 - Abnormal losses due to shrinkage or evaporation or gain due to elongation or absorption of moisture before receipt of material.
 - Changes in foreign exchange rate from the rate on date of transaction till date of payment.
 - Demurrage or detention charges or penalty levied by transport or other authorities
 - Imputed Costs.
 - Subsidy or recoveries receivable with certainty
- b. **Valuation of issue of material:**
 - i. **Issue Methods:** Issues shall be valued using appropriate methods like FIFO, LIFO and weighted average cost method.
 - ii. **Standard Costs:** If standard costs are used, then price variances related to materials shall be treated as part of material cost.
 - iii. **Abnormal Costs:** Any abnormal cost shall be excluded from the material cost.
 - iv. **Transport cost:** If material costs include transportation costs, The determination of costs of transportation shall be governed by CAS 5.

v. **Losses:**

- Normal material losses is includable
- Abnormal material losses is excludable

6. **Assignment of Costs:**

a. **Traceability:**

- i. Any material cost which is reasonably traceable to a cost object shall be assigned to such cost object.
- ii. Any material cost which is reasonably not traceable to a cost object shall be apportioned using suitable basis like technical estimates.

b. **Direct expenses relating to Materials:**

- i. **Third party charges:** If a material is processed by a third party as per specifications provided by the buyer, then charges payable to the third party shall be treated as part of the material cost.
- ii. **Subcontracting charges** if the activity is subcontracted, relating to materials, then subcontracting charges shall be treated as direct expenses and assigned directly to the cost object.

c. **Assignment of indirect materials:**

- i. 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. **Cost of molds, patterns etc:** cost of materials like catalysts, dies, tools, molds, patterns etc, which are used in production over a period of time **shall be amortized** over the production units benefited by such cost.
- iii. **Life more than a year:** Cost of indirect material with life exceeding one year shall be included in cost over the useful life of the material.

7. **Presentation in cost statements:**

a. **Appropriate headings:** Direct materials shall be classified under appropriate headings like

- Raw materials,
- Components,
- Semi-finished goods and
- Sub-assemblies

b. **Classification of direct materials.**

- Purchased
- Indigenous
- Imported
- self-manufactured

c. **Classification of indirect materials.**

- tools, stores and spares,
- machinery spares,

- jigs and fixtures,
 - consumable stores
8. **Disclosures:** The following information should be disclosed in the cost statement as a footnote or as a separate schedule.
- a. **Major items:**
 - Quantity and rates of major items of materials shall be disclosed.
 - A material item which constitutes 5% of total cost of materials is considered as major item.
 - b. **Valuation base:** basis of valuation of materials shall be disclosed.
 - c. **Change in the cost accounting principles and methods:**
 - Change in principles and methods applied in valuation of materials.
 - Which have a material impact on the value of materials
 - If impact is not ascertainable, the fact should be disclosed.
 - d. **Abnormal items:**
 - i. Total abnormal material cost excluded should be disclosed.
 - ii. demurrage or detention charges, penalty paid should be disclosed.
 - iii. Subsidy/Grant/Incentive received for materials.
 - iv. Materials procured from related parties.
 - e. Disclosure are required to be made if only material or significant.

AS 07, EMPLOYEE COST

1. Introduction

- a. Deals with the principles and methods of determining the Employee cost
- b. Deals with the principles and methods of
 - i. classification,
 - ii. measurement and
 - iii. assignment of
 - iv. Employee cost,for determination of the Cost of product or service, and the presentation and disclosure in cost statements

2. Objective:

- is to bring uniformity and consistency in the principles and methods of
- determining the Employee cost
- with reasonable accuracy.

3. Scope:

- Should be applied to cost statements
- which requires classification, measurement, assignment disclosure
- of Employee cost including those requiring attestation

4. Definitions:

- Abnormal Idle time:
 - ✓ An unusual idle time occurrence of which is irregular and

- ✓ unexpected or due to some abnormal situations like
- ✓ Idle time due to a strike, lockout or an accident
- **Direct Employee Cost:** Any Employee cost which can be attributed to a Cost object in an economically feasible way.
- **Employee cost:**
 - ✓ Employee benefits paid or payable
 - ✓ in all forms of consideration
 - ✓ given for the services rendered by employees of an entity.
- **Idle time:** The difference between the time paid for and time booked on various cost objects.

5. Principles of Measurement:

- a. Employee Cost is computed including
 - gross pay including
 - all allowances payable
 - All perquisites payable
 - All retirement benefits payable
- b. The following items are **includable**:
 - Bonus payable as Statutory Minimum or sharing of surplus.
 - Ex-gratia payment in lieu of or in addition to Bonus
 - Remuneration payable to Managerial Personnel. However remuneration payment to non- executive directors shall not be Included. Because it forms part of administrative overheads.
 - Voluntary retirement compensation, retrenchment compensation, termination compensation, amortized value over useful life is Includable.
 - If standard costing is used, wage rate variance is includable item.
 - Perquisites provided to an employee shall be valued at the total cost of all resources consumed.
- c. **Exclusions:** The following shall be excluded in computation of employee cost:
 - i. Imputed costs
 - ii. Cost of idle time Idle hours x applicable hourly rate
 - iii. Variances due to abnormal reasons
 - iv. Subsidy, grant, incentive received or receivable against employee cost
 - v. Abnormal cost
 - vi. Penalties, damages paid to statutory authorities or third parties
 - vii. Amount recovered from employees towards perquisites extended.
- d. **Changes in Principles used for measuring employee cost:** An entity can change it only if such change is required by
 - Law
 - Newly issued cost accounting standard
 - If change results in appropriate preparation and presentation of cost statements.

6. Assignment of costs:

- **If traceable to a cost object** - assigned to the cost object
- **If not directly traceable to the cost object** - assigned using suitable basis like estimates of time based on time study
- **VRS, RC etc.:**
 - ✓ It is an indirect cost and assigned to cost objects in an appropriate manner
 - ✓ Unamortized amount related to discontinued operations, shall not be treated as employee cost.
- **Recruitment costs**, training cost etc shall be treated as overheads not as employee cost.
- **OT Premium/Idle time cost:**
 - ✓ It shall be assigned directly to the cost object or treated as overheads
 - ✓ Depending on the economic feasibility and the specific circumstance.
 - Normal item is included in the cost and
 - Abnormal items are excluded from cost.

7. Presentation:

- a. Employee cost should be presented as a separate cost head in the cost statement
- b. Indirect Employee costs shall be presented in cost statements as a part of overheads relating to respective functions.
- c. Resources consumed by category wise presentation
 - i. wages salaries to permanent, temporary, part time and contract employees
 - ii. piece rate payments, overtime payments, Employee benefits

8. Disclosures: Entity should disclose the following as part of cost statement or foot note or special schedules only if material or significant.

- a. **Capital works:**
 - i. Employee cost attributable to capital works or jobs in the nature of deferred revenue expenditure
 - ii. Indicating the method followed in determining the cost of such capital work.
- b. **Separation Costs:** Separation costs payable to employees.
- c. **Abnormal Cost:** Any abnormal cost excluded from Employee cost.
- d. **Penalties:** Penalties and damages paid etc excluded from Employee cost.
- e. **Subsidies:** Any Subsidy, Grant, Incentive and any such payment reduced from Employee cost
- f. **Related party:** The Employee cost paid to related parties.
- g. **Forex:** Employee cost incurred in foreign exchange.

CAS 08C COST OF UTILITIES

1. Introduction:

- a. This standard deals with the principles and methods of
- b. classification, measurement and assignment of cost of utilities,
- c. for determination of the cost of product or service, and the presentation and disclosure in cost statements.

2. Objective:

- a. is to bring uniformity and consistency
- b. in the principles and methods of
- c. determining the cost of utilities with reasonable accuracy.

3. Scope:

- a. This standard shall be applied to cost statements which require CMAPD of cost of utilities including those requiring attestation.
- b. Cost of production for determining taxable value utilities captively consumed should be computed as per CAS 04.
- c. Non-Applicability:
 - this standard is not applicable to Entities engaged in generation and sale of utilities.
 - issues related to the ascertainment and treatment of carbon credits.

4. Definitions:

a. Utilities:

- Significant inputs such as
- power, steam, water, compressed air and the
- which are used for manufacturing process like
- but do not form part of the final product.

b. Stand-by utilities:

- Any utility created
- to safeguard against the failure of the main source of inputs.

5. Principles of measurement

- a. **Distinct cost object:** Each type of utility shall be treated as a distinct cost object.
B
- b. **Maintenance of records:** Proper records shall be maintained showing the quantity and cost of each major utility such as
 - power,
 - water,
 - steam,
 - effluent treatment and
 - other related utilities

produced and consumed by the different cost centers in such detail as to have particulars for each utility separately.

c. Purchased utility:

- i. Cost of utilities purchased shall be measured at cost of purchase.
- ii. including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement
- iii. net of trade discounts, rebates, taxes and duties refundable or to be credited iv. that can be quantified with reasonable accuracy at the time of acquisition.

d. Self-generated utility:

- Cost of self-generated utilities for own consumption shall comprise
- direct material cost,
- direct employee cost.
- direct expenses and
- factory overheads.

Note 01: SGU for Inter unit transfers - Distribution cost should also be included.

Note 02: SGU for inter-company transfers - Distribution cost and share of admin overheads should also be included.

e. Utilities generated for outside sales:

- It comprises direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost, share of administrative overheads and marketing overheads.
- The sale value of such utilities shall also include the margin.

f. Distribution Cost: The cost of utilities shall include the cost of distribution of such utilities i.e. cost of delivery of utilities up to the point of consumption.

g. Capacity:

- a. The cost of production and distribution of utilities shall be determined based on the normal capacity or actual capacity utilization whichever is higher and
- b. Unabsorbed cost, if any, shall be treated as abnormal cost.

h. Stand-by utility Cost: Cost of utility includes cost of a stand-by utility along with **committed costs of maintaining such a utility.**

6. Assignment of costs:

- **If traceable to a cost object** - assigned to the cost object
- **If not directly traceable to the cost object** - assigned using most appropriate or suitable basis i.e. derived from usage parameters

7. Presentation:

- a. Separate line item if material: Utilities costs shall be presented as a separate cost head for each type of utility in the cost statement, if material.
- b. Utility Cost sheet: If separate cost statements are prepared for utilities, cost of utilities shall be classified as
 - purchased or generated
 - quantitative information by individual consuming units,
 - inter unit transfers, inter-company transfers and sale to outside parties wherever applicable

8. Disclosures: Entity should disclose the following as part of cost statement or foot note or special schedules only if material or significant.

- ✓ **Base for distribution:** basis of distribution of Cost of Utility to the consuming
- ✓ **Utilities for outside sale:** with respect to sale of utility to outsiders the following shall be disclosed.

- cost of purchase,
 - production,
 - distribution, marketing and
 - price with reference to sales to outside parties.
- a. **Standard cost disclosures:** cost of utilities is disclosed at standard cost, the price and usage variances.
 - b. **Related party disclosures:** The cost and price of Utility received from/supplied to related parties.
 - c. **Captive consumption disclosures:** cost and price of Utility received from/supplied as interunit transfers and intercompany transfers.
 - d. **Transaction in Forex:** Cost of utilities incurred in foreign exchange.
 - e. **Subsidy, credits, recoveries:** Any Subsidy/Grant/Incentive, Credits/recoveries relating to the Cost of utilities.
 - f. **Abnormal Cost:** Any abnormal cost excluded from Cost of utilities.
 - g. **Penalties:** Penalties and damages paid etc excluded from cost of utilities
 - h. Disclosures of Changes in accounting policies and methods
9. **Common Points:**
- a. **Interest:** Finance costs incurred in connection with the utilities shall not form part of cost of utilities.
 - b. **Imputed Cost:** Cost of utilities shall not include imputed costs.
 - c. **Price Variance:**
 - ✓ Where cost of utilities is accounted at standard cost, the price variances related to utilities shall be treated as part of cost of utilities and
 - ✓ **Usage variances**
 - due to normal reasons shall be treated as part of cost of utilities.
 - due to abnormal reasons shall be treated as part of abnormal cost.
 - d. **Subsidy:** Any subsidy or grant or incentive or any such payment received or receivable with respect to any cost of utilities shall be reduced for ascertainment of the cost to which such amounts are related.
 - e. **Abnormal Cost:** Any abnormal cost where it is material and quantifiable shall not form part of the cost of utilities.
 - f. **Penalty:** Penalties damages paid to statutory authorities or other third parties shall not form part of the cost of utilities.
 - g. **Credit or recoveries:** Credits or recoveries relating to the utilities including cost of utilities provided to outside parties material and quantifiable shall be deducted from the total cost of utility to arrive at the net cost of 'utility'.
 - h. **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the cost of utilities should be made only if,
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard, or

- a change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 09 PACKING MATERIAL COST

1. Introduction:

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

2. Objective:

- is to bring uniformity and consistency
- in the principles and methods of
- determining the packing material cost with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMA PD of Packing Material Cost** including those requiring attestation.

4. Definitions:

- Packing Materials:** The cost of material of any nature used for the purpose of packing of a product. it includes to materials used to
 - ✓ hold,
 - ✓ identify.
 - ✓ describe,
 - ✓ store,
 - ✓ protect,
 - ✓ display,
 - ✓ transport,
 - ✓ promote and
 - ✓ make the product marketable.
- Primary Packing Material:** Packing material which is essential to hold and preserve the product for its use by the customer.
- Reusable Packing Material:** Packing materials that are used more than once to pack the product.
- Secondary Packing Material:** Packing material that enables to store, transport, inform the customer, promote and otherwise make the product marketable.
- Packing Material Development Cost:** Cost of evaluation of packing material such as pilot test, field test, consumer research, feedback, and final evaluation cost.

5. Principles of measurement:

- **Purchased Packing Materials:**
 - a. Purchased packing materials shall be measured at cost of purchase
 - b. including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement

- c. net of trade discounts, rebates, taxes and duties refundable or to be credited
- d. that can be quantified with reasonable accuracy at the time of acquisition.

- **Self-Manufactured:**

- a) Cost of self-manufactured packing materials for own consumption shall comprise
 - direct material cost,
 - direct employee cost,
 - direct expenses
 - Job Charges
 - factory overheads.
 - share of administrative overheads relating to production
 - share of research and development cost relating to packing materials
- b) Captively consumed packing materials shall be valued in accordance with the principles of CAS 04.

- **Issues:**

- Issue of packing materials shall be valued using appropriate assumptions on cost flow Le. FIFO, LIFO, weighted average etc.
- Selected method should be followed consistently.

- **Transportation Cost:** if packing material costs include transportation costs, it should determine as per CAS 05.

6. Assignment of costs:

- **If traceable to a cost object**-assigned to the cost object
- **If not directly traceable to the cost object** assigned using most appropriate or suitable basis Le. derived from usage parameters.
- **Reusable packing** material cost shall be assigned to the cost object on the basis of number of times/the period over which it is expected to be reused.
- **Primary packing materials** shall form part of the cost of production
- **Secondary packing materials** shall form part of distribution overheads

7. Presentation

- a. Packing Materials shall be classified as
 - primary and secondary packing materials and
 - further classification Indigenous, Imported and self-manufactured.
- b. If separate cost statements are prepared for packing costs, the cost of packing materials consumed shall be presented in terms of type of packing in which the materials are used. These statements shall include cost and quantitative Information.

8. Disclosures: Entity should disclose the following as part of cost statement or foot note or special schedules only if material or significant.

- a. **Base of valuation:** basis of valuation of Cost of packing materials.
- b. **Standard cost disclosures:** Packing material is disclosed at standard cost, the price and usage variances.
- c. **Related party disclosures:** The cost and price of packing materials received from/supplied to related parties.

- d. **Captive consumption disclosures:** cost and price of packing materials received from/supplied as inter unit transfers and Intercompany transfers.
- e. **Transaction in Forex:** Packing material cost incurred in foreign exchange.
- f. **Subsidy, credits, recoveries:** Any Subsidy/Grant/Incentive Credits/recoveries relating to the Packing materials.
- g. **Abnormal Cost:** Any abnormal cost excluded from packing material cost.
- h. **Penalties:** Penalties and damages paid etc excluded from cost of utilities
- i. Disclosures of Changes in accounting policies and methods

9. Common Points:

- a. **Interest:** Finance costs incurred in connection with the packing material shall not form part of Packing material cost.
- b. **Imputed Cost:** Packing material cost shall not include imputed costs.
- c. **Price Variance:**
 - i. Where Packing material cost is accounted at standard cost, the price variances related to utilities shall be treated as part of Packing material cost and
 - ii. Usage variances
 - due to normal reasons shall be treated as part of Packing material cost
 - due to abnormal reasons shall be treated as part of abnormal cost.
- d. **Subsidy:** Any subsidy or grant or incentive or any such payment received or receivable with respect to any Packing material cost shall be reduced for ascertainment of the cost to which such amounts are related.
- e. **Abnormal Cost:** Any abnormal cost where it is material and quantifiable shall not form part of the Packing material cost.
- f. **Penalty:** Penalties damages paid to statutory authorities or other third parties shall not form part of the Packing material cost.
- g. **Credit or recoveries:** Credits or recoveries relating to the Packing material cost shall be deducted from the total cost of packing material to arrive at the net cost of packing materials.
- h. **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the Packing material cost should be made only if,
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard, or
 - A change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 10 – DIRECT EXPENSES

1. Introduction.

- 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.

2. Objective:

- is to bring uniformity and consistency
- in the principles and methods of
- determining the Direct Expenses with reasonable accuracy.

3. Scope:

- This standard shall be applied to cost statements which require **CMA PD** of **Direct Expenses**
- including those requiring attestation.

4. Definitions: Direct Expenses:

- Expenses relating to manufacture of a product or rendering a service,
- which can be identified or linked with the cost object.
- other than direct material cost and direct employee cost.

Examples:

- royalties charged on production,
- job charges.
- hire charges for use of specific equipment for a specific job
- cost of special designs or drawings for a job
- software services specifically required for a job
- travelling Expenses for a specific job

5. Principles of measurement:

• Purchased Resources:

- ✓ Direct expenses incurred for the use of bought out resources shall be measured at invoice price or agreed price.
- ✓ including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement
- ✓ net of trade discounts, rebates, taxes and duties refundable or to be credited
- ✓ that can be quantified with reasonable accuracy at the time of acquisition.

• Self-Manufactured resources:

- ✓ Direct expenses for self-manufactured resources (example dies and tools produced) for own consumption shall comprise
 - direct material cost
 - direct employee cost,
 - direct expenses
 - Job Charges
 - factory overheads.
 - share of administrative overheads relating to production
 - share of research and development cost relating to packing materials
- ✓ Captively consumed packing materials shall be valued in accordance with the principles of CAS 04.

- **Lump-sum Expenses:**
 - Direct Expenses paid or incurred in lump-sum or which are in the nature of 'one-time' payment,
 - shall be amortized on the basis of the estimated output or benefit to be derived from such direct expenses.
 - **Test of materiality:** If an item of Direct Expenses **does not meet** the test of materiality, it can be treated as **part of overheads**.
6. **Assignment of costs: If traceable to a cost object** - assigned to the cost object
7. **Presentation:** Direct Expenses, if material, shall be presented as a separate cost head with suitable classification like Subcontract charges and Royalty on production etc.
8. **Disclosures:** Entity should disclose the following as part of cost statement or foot note or special schedules only if material or significant.
- **Base of distribution:** basis of distribution of direct expenses to various cost objects.
 - **Quantity and rates:** of items of Direct Expenses
 - **Classification:** Direct expenses representing
 - procurement of resources and
 - expenses incurred in connection with resources generated
 - **Standard cost disclosures:** Packing material is disclosed at standard cost. the price and usage variances
 - **Related party disclosures:** The cost and price of packing materials received from/supplied to related parties.
 - **Captive consumption disclosures:** cost and price of Utility received from/supplied as interunit transfers and intercompany transfers.
 - **Transaction in Forex:** Direct Expenses incurred in foreign exchange.
 - **Subsidy, credits, recoveries:** Any Subsidy/Grant/Incentive, Credits/recoveries relating to the Packing materials.
 - **Abnormal Cost:** Any abnormal cost excluded from Direct Expenses.
 - **Penalty:** Penalties damages paid to statutory authorities or other third parties shall not form part of the Direct Expenses.
 - **Credit or recoveries:** Credits or recoveries relating to the Direct Expenses shall be deducted from the total cost of Direct expenses to arrive at the net cost of Direct expenses.
 - **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the Direct Expenses should be made only if
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard, or
 - a change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 11 ADMINISTRATIVE OVERHEADS

1. Introduction.

- This standard deals with the principles and methods of

Overview of Cost Accounting Standards and GACAP

BCCA

- classification, measurement and assignment of **Administrative Overheads**,
- for determination of the cost of product or service, and the presentation and disclosure in cost statements.

2. Objective:

- is to bring uniformity and consistency
- in the principles and methods of
- determining the **Administrative Overheads** with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMAAPD** of **Administrative Overheads** including those requiring attestation.

4. Definitions:

Administrative Overheads:

Cost of all activities relating to **general management and administration** of an entity.
AOH exclude production overheads marketing overheads

5. Principles of measurement:

a. AOH shall be the aggregate of cost of **resources consumed** in activities relating to **general management and administration** of an organisation.

b. Leasing of assets:

- If operating lease - Total lease rental shall be classified as AOH.
- If financial lease - Interest portion shall be treated as finance costs.

c. Software cost:

- Software developed in house, purchased, licensed or customized or up grading cost shall be
- amortized over its estimated useful life

d. Admin services procured from outside:

- Admin services procured from outside shall be measured at invoice price or agreed price
- including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement
- net of trade discounts, rebates, taxes and duties refundable or to be credited
- that can be quantified with reasonable accuracy at the time of acquisition.

6. Assignment of costs

- If traceable to a cost object - assigned to the cost object
- If not traceable to a cost object - apportioned to the various cost objects in proportion to the benefits received.

7. Presentation:

- a. Administrative Overheads shall be presented as a separate cost head in cost statements.
- b. Elementwise information should be provided, only if material.

8. **Disclosures:** Entity should disclose the following as part of cost statement or foot note or special schedules only if material or significant.

- **Base of distribution:** basis of distribution of Administrative Overheads to various cost objects. **Standard cost disclosures:** Packing material is disclosed at standard cost, the price and usage variances.
- **Related party disclosures:** The cost and price of packing materials received from/supplied to related parties.
- **Transaction in Forex:** Administrative Overheads incurred in foreign exchange.
- **Subsidy, credits, recoveries:** Any Subsidy/Grant/Incentive Credits/recoveries relating to the Packing materials.
- **Abnormal Cost:** Any abnormal cost excluded from Administrative Overheads.
- **Penalties:** Penalties and damages paid etc excluded from cost of utilities
- Disclosures of Changes in accounting policies and methods

9. **Common Points:**

- **Interest:** Finance costs incurred in connection with the packing material shall not form part of Administrative Overheads.
- **Imputed Cost:** Administrative Overheads shall not include imputed costs
- **Price Variance:**
 - Where Administrative Overheads is accounted at standard cost, the price variances related to Administrative Overheads shall be treated as part of Administrative Overheads and
 - Usage variances
 - ✓ due to normal reasons shall be treated as part of Administrative Overheads
 - ✓ due to abnormal reasons shall be treated as part of abnormal cost.
- **Subsidy:** Any subsidy or grant or incentive or any such payment received or receivable with respect to any Administrative Overheads shall be reduced for ascertainment of the cost to which such amounts are related.
- **Abnormal Cost:** Any abnormal cost where it is material and quantifiable shall not form part of the Administrative Overheads.
- **Penalty:** Penalties damages paid to statutory authorities or other third parties shall not form part of the Administrative Overheads.
- **Credit or recoveries:** Credits or recoveries relating to the AOH shall be deducted from the total AOH to arrive at the net cost of AOH.
- **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the Administrative Overheads should be made only if,
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard, or
 - A change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 12 – REPAIRS & MAINTENANCE COST

1. Introduction.

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

2. Objective:

- is to bring uniformity and consistency.
- in the principles and methods of
- determining the **Repairs and Maintenance Cost** with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMAAPD** of **Repairs and Maintenance Cost** including those requiring attestation.

4. Definitions:

Repairs and Maintenance Cost:

- Cost of all activities with the objective of **maintaining or restoring an asset** in or to a state in which it can **perform its required function at intended capacity and efficiency**.
- R & M includes the **following types**:
 - routine or preventive maintenance
 - planned or corrective maintenance
 - breakdown maintenance

5. Principles of measurement:

- **R&M** shall be the aggregate of cost of **resources consumed** in activities relating to repairs and maintenance activity. Example of resources consumed.
 - ✓ cost of materials, consumable stores, spares,
 - ✓ manpower,
 - ✓ equipment usage, utilities and other identifiable resources consumed in such activity.
 - ✓ cost of resources common to various R&M activities such as
 - manpower,
 - equipment usage and
 - other costs allocable to such activities
- **In-house R&M**: It shall include
 - ✓ cost of materials,
 - ✓ consumable stores, spares
 - ✓ manpower,
 - ✓ equipment usage,
 - ✓ utilities, and other resources used in such activity.

- **R&M by Outside Contractors inside the entity:**
 - R&M 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
- **R&M by outside contractor at its premises:**
 - ✓ It 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.
- **Distinct activity:**
 - ✓ Each type of repairs and maintenance shall be treated as a distinct activity, if material and identifiable
 - ✓ It shall be measured for each major asset category separately.
- **Cost of spares:**
 - ✓ Spares replaced **which do not enhance the future economic benefits** from the existing asset shall be included under R & M cost.
 - ✓ **High value spare:** If replaced by new spare
 - If recognition criteria of a PPE is met- recognize as PPE and depreciate
 - If recognition criteria of a PPE is not met- consider as inventory and recognize as cost when they consumed.
 - ✓ **Major overhaul cost:** Cost of major overhaul shall be amortized on a rational basis.
- 6. **Assignment of costs:**
 - ✓ If traceable to a cost object- assigned to the cost object
 - ✓ If not traceable to a cost object: it shall be assigned based on either of the following two principles
 - Cause and effect
 - Benefits received
 - ✓ If R & M cost is shared by several cost objects apportionment using appropriate basis as laid down in CAS 03.
- 7. **Presentation:**
 - ✓ Repairs and Maintenance Cost shall be presented as a separate cost head in cost statements.
 - ✓ Elementwise information should be provided, only if material like
 - Asset category wise
 - Activity wise details
- 8. **Disclosures:** Entity should disclose the following as part of cost statement or foot note or special schedules only if material or significant.
 - **Base of distribution:** basis of distribution of Repairs and Maintenance Cost to various

cost objects.

- **Standard cost disclosures:** Packing material is disclosed at standard cost the price and usage variances
- **Related party disclosures:** The cost and price of repairs and maintenance services received from/supplied to related parties.
- **Transaction in Forex:** Repairs and Maintenance Cost incurred in foreign exchange.
- **Subsidy, credits, recoveries:** Any Credits/recoveries relating to the Repairs and Maintenance. f. **Abnormal Cost:** Any abnormal cost excluded from Repairs and Maintenance Cost.
- **Penalties:** Penalties and damages paid etc excluded from cost of utilities
- **Inhouse & outsourced:** R&M cost of Jobs done in-house and outsourced separately presented.
- **Major overhauls;** should be presented by asset category wise and the basis of amortization.
- Disclosures of **Changes in accounting policies** and methods

9. Common Points:

- a. **Interest:** Finance costs incurred in connection with the Repairs and Maintenance shall not form part of Repairs and Maintenance Cost.
- b. **Imputed Cost:** Repairs and Maintenance Cost shall not include imputed costs
- c. **Price Variance:**
 - Where Repairs and Maintenance Cost is accounted at standard cost, the price variances related to Repairs and Maintenance Cost shall be treated as part of Repairs and Maintenance Cost and
 - Usage variances
 - due to normal reasons shall be treated as part of Repairs and Maintenance Cost
 - due to abnormal reasons shall be treated as part of abnormal cost.
 - **Subsidy:** Any subsidy or grant or incentive or any such payment received or receivable with respect to any Repairs and Maintenance Cost shall be reduced for ascertainment of the cost to which such amounts are related.
 - **Abnormal Cost:** Any abnormal cost where it is material and quantifiable shall not form part of the Repairs and Maintenance Cost.
 - **Penalty:** Penalties damages paid to statutory authorities or other third parties shall not form part of the Repairs and Maintenance Cost.
 - **Credit or recoveries:** Credits or recoveries relating to the Repairs and Maintenance shall be deducted from the total Repairs and Maintenance cost to arrive at the net cost of Repairs and Maintenance.
 - **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the Repairs and Maintenance Cost should be made only if
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard. Or
 - a change would result in a more appropriate preparation or presentation of cost

statements of an organization.

CAS 13 COST OF SERVICE COST CENTRE

1. Introduction:

- 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.

2. Objective:

- is to bring uniformity and consistency.
- in the principles and methods of determining the Cost of Service Cost Centre with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMA PD** of **Cost of Service Cost Centre** including those requiring attestation.

4. Definitions

Service Cost Centre:

- a. The cost center which primarily provides auxiliary services across the entity is known as service cost center.
- b. The cost center which provides services to Production, Operation or other Service Cost Centre but not directly engaged in manufacturing process or operation is a service cost center.

c. Examples:

engineering workshop, research & development, quality control, quality assurance, designing laboratory, welfare services, safety, transport. Component. Tool stores, Pollution Control, Computer Cell, dispensary, school, crèche, township, Security etc

5. Principles of measurement:

- a. **Cost of service cost centre** shall be the aggregate direct and indirect cost attributable to services being rendered by such cost centre.
- b. **In-house services:** It include
 - cost of materials, consumable stores, spares,
 - manpower, equipment usage, utilities, and other resources used in such service
- c. **Services by Contractors within the entity:** Cost of services rendered by contractors with in the facilities of the entity shall include
 - Charges payable to the contractor and
 - cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and
 - other resources provided to the contractors for such services.
- d. **Services by contractors at their premises:**
 - i. Cost of services rendered by contractors at their premises shall be determined

at invoice or agreed price

- ii. including duties and taxes, and other expenditure directly attributable thereto
- iii. net of discounts (other than cash discount), taxes and duties refundable or to be credited.
- iv. This cost shall also include the cost of resources provided to the contractors.

e. Cost of captive consumption:

1. **Inter unit transfers:** it should include **distribution costs** incurred for such transfers.
2. **Inter-company transfers:** It should include distribution cost and administrative OH.
3. **Services to outside parties:** It should include **distribution cost**, administrative OH and **marketing OH**.
4. **Capacity:**
 - Cost of production and distribution of the service shall be determined based on the normal capacity or actual capacity utilization whichever is higher.
 - Unabsorbed cost shall be treated as abnormal cost.
 - Cost of a Stand-by service shall include the committed costs of maintaining such a facility for the service.

6. Assignment of costs:

- **If traceable to a cost object** - assigned to the cost object
- **If not traceable to a cost object:** it shall be assigned based on most appropriate basis.

7. Presentation:

Cost of Service Cost Centre shall be presented as a separate cost head in cost statements, if material.

8. Disclosures: Entity should disclose the following as part of cost statement or foot note or special schedules only if material or significant.

- a. **Base of distribution:** basis of distribution of Cost-of-Service Cost Centre to various cost objects.
- b. **Sale to outside parties:** cost of purchase, production, distribution, marketing and price of services.
- c. **Standard cost disclosures:** cost of service cost centre is disclosed at standard cost, the price and usage variances
- d. **Related party disclosures:** The cost services received from/supplied to related parties.
- e. **Transaction in Forex:** Cost of Service Cost Centre incurred in foreign exchange
- f. **Subsidy, credits, recoveries:** Any Subsidy/Grant/Incentive, exchange. Credits/recoveries relating to the Cost of service cost centre.
- g. **Abnormal Cost:** Any abnormal cost excluded from Cost-of-Service Cost Centre.
- h. **Penalties:** Penalties and damages paid etc excluded from cost of service cost centre
- i. Disclosures of **Changes in accounting policies** and methods.

9. Common Points:

- a. **Interest:** Finance costs incurred in connection with the cost of services shall not form part of Cost-of-Service Cost Centre.
- b. **Imputed Cost:** Cost of Service Cost Centre shall not include imputed costs.
- c. **Price Variance:**
 - Where Cost of Service Cost Centre is accounted at standard cost, the price variances related to Cost of Service Cost Centre shall be treated as part of Cost of Service Cost Centre and
 - Usage variances
 - ✓ due to normal reasons shall be treated as part of Cost of Service Cost Centre
 - ✓ due to abnormal reasons shall be treated as part of abnormal cost.
- d. **Subsidy:** Any subsidy or grant or incentive or any such payment received or receivable with respect to any Cost of Service Cost Centre shall be reduced for ascertainment of the cost to which such amounts are related.
- e. **Abnormal Cost:** Any abnormal cost where it is material and quantifiable shall not form part of the Cost of Service Cost Centre.
- f. **Penalty:** Penalties damages paid to statutory authorities or other third parties shall not form part of the Cost of Service Cost Centre.
- g. **Credit or recoveries:** Credits or recoveries relating to the Repairs and Maintenance shall be deducted from the total Cost of Service Cost Centre to arrive at the net cost of Repairs and Maintenance.
- h. **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the Cost of Service Cost Centre should be made only if,
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard, or
 - a change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 14 POLLUTION CONTROL COST

1. Introduction:

- a. This standard deals with the principles and methods of
- b. classification, measurement and assignment of Pollution control cost,
- c. for determination of the cost of product or service, and the presentation and disclosure in cost statements.

2. Objective:

- a. is to bring uniformity and consistency
- b. in the principles and methods of
- c. determining the **Pollution Control Cost** with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMA PD** of **Pollution Control Cost** including those requiring attestation.

4. Definitions:

- **Air pollutant:** It means any **solid, liquid or gaseous substance** including noise present in the atmosphere in such concentration as may be or tend to be injurious to human beings or other living creatures or plants or property or environment.
- **Air Pollution:** It means the presence in the atmosphere of any air pollutant
- **Environment:** It includes **water, air and land** and the inter-relationship which exists among and between water, air and land, and human beings, other living creatures, plants, micro-organism and property.
- **Environmental Pollutant:** Environmental Pollutant means any solid, liquid or gaseous substance present in such concentration as may be, or tend to be, injurious to environment.
- **Environment Pollution:** Environmental pollution means the **presence in the environment of any environmental pollutant**.

Pollution Control:

- It means the control of emissions and effluents into environment.
- It constitutes the use of materials, processes, or practices to reduce 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.
- **Soil Pollutant:** it is a substance which is the source of soil contamination.
- **Soil Pollution:** It means the presence of any soil pollutant in the soil which is **harmful to the living beings** when it crosses its threshold concentration level.
- **Water pollution:**
 - It means such contamination of water or such alteration of the physical, chemical or biological properties of water or
 - such discharge of any sewage or trade effluent or of any other liquid, gaseous or solid substance into water as may, or
 - is likely to render such water harmful or injurious to public health or safety, or to domestic, commercial, industrial, agricultural or other legitimate uses, or to the life and health of animals or plants or of aquatic organisms.
- **Pollution Control costs:** It is aggregate of direct and indirect cost relating to Pollution Control activity.

5. Principles of measurement:

a. in-house Pollution Control activity:

- Pollution Control cost which is internal to the entity should be accounted for when incurred.
- They should be measured at the historical cost of resources consumed.
- It includes the following:
 - ✓ cost of materials,
 - ✓ consumable stores

- ✓ spares
- ✓ manpower.
- ✓ equipment usage
- ✓ utilities,
- ✓ and other resources used in such activity.

b. Pollution Control activity carried out by outside contractors inside the entity:

- It 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.

c. Pollution Control jobs carried out by contractor at its premises:

- It 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
- This cost shall also include the cost of other resources provided to the refundable or to be credited.

d. contractors By type of pollution Control:

- Each type of Pollution Control eg water, air, soil pollution shall treated as a distinct activity, be
- if material and identifiable

e. Disposal Cost:

- Disposal costs which are expected to be incurred with reasonable certainty as part of Onerous Contract or Constructive Obligation. legally enforceable shall be estimated and
- Accounted based on the quantum of pollution generated in each period and the associated cost of remediation or disposal in future.

f. Contingent future remediation or disposal costs:

- These refers to costs that are likely to arise on account of future legislative changes on pollution control
- shall not be treated as cost until the incidence of such costs become reasonably certain and can be measured.

g. R&D Cost:

- R&D cost to develop new process, new products or use of new materials to avoid or mitigate pollution shall be treated as research and development costs and not included under pollution control costs.
- Development costs incurred for commercial development of such product, process or material shall be included in pollution control costs

6. Assignment of costs

- a. **If traceable to a cost object** - assigned to the cost object
- b. **If not traceable to a cost object:** it shall be assigned based on any one of the following bases.
 - ✓ Cause and Effect

- ✓ Benefits received

c. **Shared by several cost objects:** Aggregate cost shall be distributed among the cost objects as per principles laid down in CAS 03.

7. Presentation

- Pollution control Cost shall be presented as a separate cost head in cost statements, if material.
- Pollution control cost Presented duly classified as shown below:
 - ✓ Direct and Indirect cost
 - ✓ Internal and External costs
 - ✓ Current and future costs
 - ✓ Domain area e.g. water, air and soil.
- Activity wise details of Pollution Control cost, if material, shall be presented separately.

8. **Disclosures:** Entity should disclose the following as part cost statement or foot note or special schedules only if material or significant.

- **Base of distribution:** basis of distribution of pollution control Cost to various cost objects.
- **Standard cost disclosures:** Pollution control cost centre is disclosed at standard cost, the price and usage variances
- **Related party disclosures:** The pollution control cost paid or payable to related parties.
- **Transaction in Forex:** Pollution control incurred in foreign exchange.
- **Subsidy, credits, recoveries:** Any Subsidy/Grant/Incentive, Credits/recoveries relating to the Pollution control cost.
- **Abnormal Cost:** Any abnormal cost excluded from pollution control Cost.
- **Penalties:** Penalties and damages paid etc excluded from pollution control cost.
- **Disclosures of Changes in accounting policies and methods**

9. Common Points:

- **Interest:** Finance costs incurred in connection with the pollution control cost shall not form part of pollution control Cost.
- **Imputed Cost:** Pollution control Cost Centre shall not include imputed costs
- **Price Variance:**
 - Where Pollution control cost is accounted at standard cost.
 - **Price variance:** The price variances included in Pollution control cost
 - **Usage variance:**
 - a. due to normal reasons shall be treated as part of Cost.
 - b. due to abnormal reasons shall be treated as part of abnormal cost.
- **Subsidy:** Any subsidy or grant or incentive or any such payment received or receivable with respect to any pollution control cost shall be reduced for ascertainment of the cost to which such amounts are related.
- **Abnormal Cost:** Any abnormal cost where it is material and quantifiable shall not form part of the Pollution control cost.

- **Penalty:** Penalties damages paid to statutory authorities or other third parties shall not form part of the Pollution control cost.
- **Credit or recoveries:** Credits or recoveries relating to the Pollution control cost shall be deducted from the total pollution control cost.
- **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the pollution control cost should be made only if
 - ✓ it is required by law or
 - ✓ for compliance with the requirements of a cost accounting standard, or
 - ✓ a change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 15 - SELLING DISTRIBUTION OVERHEADS

1. Introduction:

- This standard deals with the principles and methods of
- classification, measurement and assignment of S&D cost,
- for determination of the cost of product or service, and the presentation and disclosure in cost statements,

2. Objective:

- is to bring uniformity and consistency
- in the principles and methods of
- determining the S&D Cost with reasonable accuracy.

3. Scope

This standard shall be applied to cost statements which require **CMAAPD** of **S & D Cost** including those requiring attestation.

4. Definitions:

- **Selling Overheads:**

- Refers to expenses related to sale of products or services and
- include all indirect expenses incurred in selling the products or services
- Example: Salaries of sales personnel, Travelling expenses of sales personnel, Commission to sales agents, advertisement, publicity. Receivable Collection costs, After sales service costs, Warranty costs etc.

- **Distribution overheads:**

- Refers to costs incurred in handling a product or service from the time it is ready for dispatch or delivery until it reaches the ultimate consumer
- including the units receiving the product or service in an inter-unit transfer.
- **Examples:** cost of packing, repacking, labelling

5. Principles of Measurement:

- S&D OH: It is Aggregate of the cost of resources consumed in the selling and distribution activities of the entity,
- Resources procured from outside:
 - ✓ It shall be determined at invoice or agreed price including duties and taxes,

and other expenditure directly attributable thereto.

- ✓ net of discounts (other than cash discounts), taxes and duties refundable or to be credited by the Tax Authorities.
- **Amortization:** S&D Overheads which offers benefits over a long period shall be amortized on a rational basis.

6. Assignment of Cost:

- **If traceable to a cost object** - assigned to the cost object.
- **If not traceable to a cost object:** it shall be assigned based on any one of the following bases.
 - ✓ Cause and Effect
 - ✓ Benefits received.
- **Transportation Cost:** outward transportation cost which form part of distribution cost shall be determined as per CAS 05.

7. Presentation:

- **Separate heading:** S&D overheads shall be presented as a separate cost head in the cost statement.
- **Element-wise** details shall be presented, if material.

8. Disclosures: Entity should disclose the following as part cost statement or foot note or special schedules only if material or significant.

- **Basis of distribution:** The basis of distribution of Selling and Distribution Overheads to the cost objects.
- **Forex:** Selling and Distribution Overheads incurred in foreign exchange.
- **Related party Transactions:** Cost of Selling and Distribution services rendered to related parties.
- **Subsidy:** Any Subsidy or Grant or Incentive and any such payment reduced from Selling and Distribution Overheads.
- **Credits:** Credits or recoveries relating to the Selling and Distribution Overheads
- **Penalties:** Penalties and damages excluded from the Selling and Distribution Overheads.
- **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the pollution control cost should be made only if
 - ✓ it is required by law or
 - ✓ for compliance with the requirements of a cost accounting standard or
 - ✓ a change would result in a more appropriate preparation or presentation of cost statements of an organization

Note 01: Refer to common points for CAS

CAS 16-DEPRECIATION AND AMORTISATION

1. Introduction.

- This standard deals with the principles and methods of
- classification, measurement and assignment of Depreciation and Amortization cost.

- for determination of the cost of product or service, and the presentation and disclosure in cost statements

2. Objective.

- is to bring uniformity and consistency.
- in the principles and methods of
- determining the Depreciation and Amortization Cost with reasonable accuracy.

3. Scope

This standard shall be applied to cost statements which require **CMAAPD** of **Depreciation and Amortization Cost** including those requiring attestation.

4. Definitions:

- **Amortization:** It is the **systematic allocation** of the depreciable amount of an intangible asset over its useful life.
- **Depreciation:** It is the systematic allocation of the depreciable amount of a tangible asset over its useful life.
- **Depreciable amount:** Cost of an asset as reduced by residual value.
- **Impairment Loss:** Carrying Amount - Recoverable value of an asset.

5. Principles of Measurement

- a. **Factors:** Depreciation and Amortization shall be measured based on the
 - depreciable amount Historical Cost-Scrap value
 - useful life = period over which the asset is expected to be used for production or provision of services.
- b. **Residual Value:** The residual value of an intangible asset shall be assumed to be zero unless:
 - There is a commitment by a third party to purchase the asset at the end of its useful life; or
 - there is an active market for the asset.
- c. **Regulated Industry:** Depreciation shall be as prescribed by the concerned regulator.
- d. **Factors to be considered for useful life:** While estimating the useful life of
 - depreciable asset, consideration shall be given to the following factors:
 - ✓ Expected physical wear and tear
 - ✓ Obsolescence; and
 - ✓ Legal or other limits on the use of the asset.
- e. **Intangibles arising from contractual rights.**
 - The useful life of intangible asset shall not exceed period of the contractual or other legal rights, but
 - may be shorter depending on the period over which the entity expects to use the asset.
- f. **Commencement of depreciation:**
 - Depreciation of an asset begins when it is available for use, i.e.,
 - when it is in the location and condition necessary for it to be capable of operating

in the manner intended by management

- g. **Depreciation on Additions:**
 - **Integral additions:** Depreciation on such addition shall be provided based on remaining useful life of such asset.
 - **non-integral additions** - Depreciation on such addition shall be provided based on estimated useful life of such addition.
 - h. **Depreciation on revalued asset:** impact of higher depreciation due to revaluation of asset shall not be assigned to cost object.
 - i. **Impairment loss to be excluded:** Impairment loss on assets shall be excluded from cost of production.
 - j. **Dep Method to reflect expected benefits:** Depreciation method used shall reflect the pattern in which the asset's future economic benefits expected from such asset.
 - k. **Methods of depreciation:** Entity can use any one of the following methods
 - Straight-line method
 - Diminishing balance method and
 - Units of production method
 - l. **Amortization method to reflect expected benefits:** Amortization method of intangible asset shall reflect the pattern in which the economic benefits are expected from such asset.
 - m. **Annual review:**
 - Methods and rates of depreciation applied shall be reviewed at least annually.
 - If there has been a change in the expected pattern of consumption or loss of future economic benefits, the method applied shall be changed. to reflect the changed pattern
 - n. **Spare parts, stand-by equipment, and servicing equipment:**
 - If meets recognition criteria of a PPE-recognize as PPE and depreciate over useful life
 - If not, recognize as inventory and consider as a cost when such items were used
 - o. **Small assets:** shall be written off in the period in which they were purchased based on accounting policy of the entity.
 - p. **Not to provide depreciation:** if accumulated depreciation exceeds historical cost of the asset, then no depreciation required to be provided.
6. **Assignment of Costs:**
- ✓ **If traceable to a cost object-**assigned to the cost object
 - ✓ **If not traceable to a cost object:** it shall be assigned based on any one of the following bases
 - Cause and Effect
 - Benefits received.
 - ✓ **Depreciation on Retired or idle assets:** Depreciation on asset remains idle. or retired from production shall be treated as abnormal cost.

- ✓ **PPE used for producing another asset:** Depreciation shall form part of cost of such new asset.
- 7. **Presentation:** Depreciation and Amortization shall be presented in the cost statement as a separate cost item, if material
- 8. **Disclosures:** Entity should disclose the following as part cost statement or foot note or special schedules only if material or significant.
 - a. **Basis of distribution:** The basis of distribution of depreciation and amortization to the cost objects.
 - b. **Credits:** Any credits/recoveries relating to Depreciation and Amortization.
 - c. **Additional Depreciation** on account of revaluation of asset, which is not included in cost.
 - d. Amount of depreciation that is not included in cost because of **temporary retirement of assets** from production of goods and services.
 - e. **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the pollution control cost should be made only if,
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard, or
 - a change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 17 - INTEREST AND FINANCING CHARGES

1. Introduction.

- This standard deals with the principles and methods of
- classification, measurement and assignment of **Interest and Financing charges**,
- for determination of the cost of product or service, and the presentation and disclosure in cost statements

2. Objective.

- is to bring uniformity and consistency.
- in the principles and methods of
- determining the Interest and financing charges with reasonable accuracy.

3. Scope

This standard shall be applied to cost statements which require **CMA PD** of **Interest and financing charges** including those requiring attestation.

4. Definitions:

Interest and Finance charges:

- It refers to interest and other costs incurred by an entity in connection with the finance arrangements.
- Examples are:
 - ✓ Interest and commitment charges
 - ✓ Financing Charges in respect of finance leases and other similar arrangements: and

- ✓ Exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs

5. Principles of measurement.

- **As per AS:** Interest and Financing Charges shall be measured in accordance with the Accounting Standards.
- **Types:** Interest and Financing Charges incurred shall be identified
 - acquisition/construction/ production of qualifying assets
 - Other finance costs for production of goods/ operations or services rendered which cannot be classified as qualifying assets.
- **Treatment:** Interest relating to acquisition or construction of qualifying assets should be capitalized
- **Interest paid for or received on investment shall not form part of the other financing charges** for production of goods/operations or services rendered.

6. Assignment of costs:

- ✓ **If traceable to a cost object** - assigned to the cost object
- ✓ **If not traceable to a cost object:** it shall be assigned based on any one of the following bases.
 - Cause and Effect
 - Benefits received

7. Presentation: it shall be presented in the cost statement as a separate item of cost of sales

8. Disclosures: Entity should disclose the following as part cost statement or foot note or special schedules only if material or significant.

- **Distribution basis:** The basis of distribution of Interest and Financing Charges to the cost objects/cost units.
- **Standard Rates:** if predetermined cost is applied in Interest and Financing Charges, the rate and usage variances
- **Related party transactions:** Interest and Financing Charges paid/payable to related parties
- **Forex:** Interest and Financing Charges incurred in foreign exchange
- **Subsidy:** Any Subsidy/ Grant/ Incentive or any amount of similar nature received/ receivable reduced Interest and Financing Charges
- **Prior period Items:** Interest and Financing Charges incurred relating to prior periods and taken to reconciliation directly shall be disclosed separately.
- **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the pollution control cost should be made only if,
 - ✓ it is required by law or
 - ✓ for compliance with the requirements of a cost accounting standard or
 - ✓ a change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 18 RESEARCH AND DEVELOPMENT COSTS

1. Introduction.

- a. These standard deals with the principles and methods of
- b. classification, measurement and assignment of Research and development cost.
- c. for determination of the cost of product or service, and the presentation and disclosure in cost statements.

2. Objective:

- a. is to bring uniformity and consistency.
- b. in the principles and methods of
- c. determining the Research and development costs with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMAAPD of Research and development cost** including those requiring attestation.

4. Definitions:

a. Research:

- It is an original and planned investigation undertaken.
- with the prospect of gaining new scientific or technical knowledge and understanding.

b. Research Cost:

- It is the cost of original and planned investigation undertaken.
- with the prospect of gaining new scientific or technical knowledge and understanding

c. Development cost:

- It is the cost for application of research finding or other knowledge.
- to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems, or services.
- before the start of commercial production or use

5. Principles of Measurement.

a. Direct and Indirect: R&D costs shall include

- all the costs that are directly traceable to research and/or development activities or
- that can be assigned to research and development activities strictly on the basis of (a) cause and effect or (b) benefits received

b. R&D Cost is aggregate of the following elements of cost.

- Cost of materials and services consumed in R&D
- Cost of bought out materials and hired services as per invoice or agreed price.
- Salaries, wages and other related costs of personnel engaged in R&D
- Depreciation of equipment and facilities, and other tangible assets, and amortization of intangible assets relating to R&D.
- Overhead costs relating to R&D
- Expenditure incurred in securing copyrights or licenses
- Expenditure incurred for developing computer software

- Costs incurred for the design of tools, jigs, molds and dies
 - Other costs that can be directly attributed to Research, and Development activities
6. **Assignment of costs:**
- R&D Cost attributable to a specific cost object shall be assigned to that cost object.
 - R&D Cost which are not attributable to a specific product shall not form part of the product cost.
 - Development cost which brings an intangible asset into existence shall be amortized over its useful life.
 - The assignment of development cost should be based on benefits received.
 - R&D Costs incurred for the development of an existing process or product shall be included in the cost of production.
 - Development costs attributable to a saleable service shall be accumulated separately and treated as cost of providing the service.
7. **Presentation:** R & D Cost relating to
- improvement item of cost of the process or products or services presented as a separate
 - if not related to improvement of process or products or services shall be presented as part of the reconciliation statement.
8. **Disclosures:** Entity should disclose the following as part cost statement or foot note or special schedules only if material or significant
- ✓ **Basis of assignment:** basis of accumulation and assignment of Research and Development costs.
 - ✓ **Related party transactions:** R&D costs paid to related parties.
 - ✓ **Forex:** R&D cost incurred in foreign exchange
 - ✓ **Subsidy:** Any Subsidy/Grant/Incentive and any such payment reduced from R&D cost
 - ✓ **Credits:** Credits/recoveries deducted from the Research, and Development cost
 - ✓ **Abnormal Cost:** Any abnormal cost excluded from R&D cost including cost of abandoned projects and research activities is considered abnormal.
 - ✓ **Penalty:** Penalties and damages paid etc. excluded from R & D cost.
 - ✓ **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the pollution control cost should be made only if.
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard, or
 - a change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 19-10 INT COSTS

1. Introduction:

- This standard deals with the principles and methods of
- classification, measurement, and assignment of Joint Cost

- for determination of the cost of product or service, and the presentation and disclosure in cost statements.

2. Objective:

- is to bring uniformity and consistency.
- in the principles and methods of
- determining the Joint Cost with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMAAPD** of **Joint Cost** including those requiring attestation.

4. Definitions:

- **Joint Costs:** it refers to cost of common resources used to produce two or more products or services simultaneously.
- **Joint products:**
 - Products or services that are produced simultaneously, by the same process,
 - having the same or substantially same realizable values.
- **Main & By-Product:**
 - Products or services that are produced simultaneously by the same process
 - The product which has significantly high realizable value is called as Main Product
 - The Product with relatively low realizable value or negligible realizable value produced incidentally in the manufacturing of the product is called as by-product
- **Split off point:**
 - The point in the production process
 - at which joint products or main and by-products become separately identifiable

5. Principles of Measurement:

a. **Principles of CAS:** Joint costs upto the split off point shall be determined by applying the principles and methods that are stipulated in other CAS.

b. Post separation Cost:

- Cost incurred to further process the products after the split off point is known as post separation cost.
- It shall be measured for the resources consumed for each Joint/By- Product.
- Post separation cost is an aggregate of Direct and indirect costs incurred on each product.

c. Further processing by outside parties:

- shall be determined at invoice or agreed price
- including duties and taxes,
- net of discounts (other than cash discount) taxes and duties refundable or to be credited and
- other expenditure directly attributable to such processing.
- This cost shall also include the cost of resources provided to outside parties.

d. **Treatment of scrap:** If the production process results any scrap or waste, net realizable value of such scrap should be reduced from cost of joint products.

- e. **Subsidy:** Any Subsidy / Grant / Incentive or any such payment received / receivable with respect to any joint product /By-Product shall be reduced for ascertainment of the cost to which such amounts are related.
 - f. **Penalties:** Any penalty, damages paid to statutory authorities or other third parties shall not form part of the cost of the joint product /By-Product.
6. **Assignment of Costs:**
- a. **Assignment:** Joint cost incurred shall be assigned to joint products based on benefits received, by using any of the following methods:
 - Physical Units Method. .
 - Net Realizable Value at split-off point
 - Technical estimates
 - b. **Valuation of by-product:** it shall be estimated by using any of the following methods. i.
 - Net realizable value method = Sale value of by product - post split off cost incurred.
 - Technical Estimates - this method should be used, if or
7. **Presentation:** Cost Statement shall present
- the element wise cost of individual products produced jointly and
 - the value assigned to By-Products.
8. **Disclosures:** Entity should disclose the following as part cost statement or foot note or special schedules only if material or significant
- **Basis of allocation:** basis of allocation of Joint costs to individual products and the value assigned to the By-Products.
 - **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the pollution control cost should be made only if.
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard or
 - a change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 20-ROYALTY AND TECHNICAL KNOW-FEE

1. Introduction.

- This standard deals with the principles and methods of
- classification, measurement, and assignment of **Royalty and technical know-how fee**,
- for determination of the cost of product or service, and the presentation and disclosure in cost statements.

2. Objective:

- is to bring uniformity and consistency.
- in the principles and methods of
- determining the **Royalty and technical know-how fee** with reasonable accuracy.

3. Scope

This standard shall be applied to cost statements which require **CMAAPD** of **Interest and financing charges** including those requiring attestation.

4. Definitions:

➤ Royalty:

- It refers to any consideration for the use of asset to the owner.
- It is often expressed.
 - ✓ as a percentage of the revenues obtained by use of the owners asset
 - ✓ per unit of production or sales value.
- Royalty is consideration paid for use of
 - ✓ Non-renewable resource.
 - ✓ Patents.
 - ✓ Trademarks.
 - ✓ Franchise rights.
 - ✓ Copy rights;
 - ✓ artwork, software and the like.

➤ **Technical service fee:** it refers to any consideration payable to provider of

- technical or
- managerial services.

5. Principles of Measurement:

➤ **Lump-sum payments:**

- If royalty in lump-sum or which are in the nature of 'one-time' payment,
- shall be amortized on the basis of the estimated output or benefit to be derived from the related asset.

6. Assignment of costs:

- If **directly traceable to a cost object** - shall be assigned to that cost object
- If **not directly traceable** - it shall be assigned to various cost objects based on any of one of the following bases.
 - Units produced.
 - Units sold
 - Sales value
- **Mining Rights:** Royalty fee paid for mining rights shall form part of material cost.
- **Assignment based on nature:** Royalty and Technical Know-how fee shall be assigned on the nature/ purpose of such fee.

7. **Presentation:** Royalty and Technical Know-how fee shall be presented as a separate cost head with suitable classification

8. **Disclosures:** Entity should disclose the following as part cost statement or foot note or special schedules only if material or significant

- ✓ **Basis of distribution:** The basis of distribution of the amount Royalty and Technical Know-how fee to the cost objects/ cost units.
- ✓ **Quantity and rates:** Quantity and the related rate of items of the amount of Royalty

and Technical Know-how fee, as applicable.

- ✓ **Related party transactions:** Royalty and Technical Know-how fee paid/ payable to related parties.
- ✓ **Forex:** Royalty and Technical Know-how fee incurred in foreign exchange
- ✓ **Subsidy:** Any Subsidy/Grant/Incentive and any such payment reduced from the amount of Royalty and Technical Know-how fee.
- ✓ **Credits:** Credits/recoveries relating to the amount of Royalty and Technical Know-how fee.
- ✓ **Penalties:** Penalties and damages excluded from the amount of Royalty and Technical Know-how fee.
- ✓ **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the pollution control cost should be made only if
 - It is required by law or
 - for compliance with the requirements of a cost accounting standard, or
 - a change would result in a more appropriate preparation or presentation of cost statements of an organization

CAS 21 - QUALITY CONTROL

1. Introduction:

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

2. Objective:

- is to bring uniformity and consistency.
- in the principles and methods of
- determining Quality Control with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMA** of **Quality Control** including those requiring attestation.

4. Definitions:

a. Quality

- Quality is the **conformance to requirements** or specifications.
- The quality of a product or service is **fitness** of that product or service for **meeting its intended use as required by customer**.

b. Quality control:

- It is a **set of procedures**.
- exclusively designed to **ensure** that products or services.
- **adhere to a defined set of quality criteria** or meet requirements of the customer.

c. **Quality Control cost:** It refers to the cost of resources consumed towards quality

control procedures to ensure products or services meets quality requirements of the customers.

5. Principles of Measurement:

a. In-house quality cost:

- i. It is an aggregate of the cost of resources consumed in the Quality Control activities of the entity.
- ii. Resources procured from outside for using in in-house quality function, shall be
 - determined at **invoice or agreed price**.
 - including duties and taxes, and other expenditure directly attributable there to
 - net of discounts (other than cash discounts), taxes and duties refundable or to be credited by the Tax Authorities:

b. The following are not included in quality cost:

- Interest and finance charges
- Imputed costs
- Subsidy or grant or incentive received against the quality control cost incurred.
- Abnormal cost
- Penalties and damages paid to statutory authorities or to third parties.

6. Assignment of costs:

- ✓ **If directly traceable to a cost object**-shall be assigned to that cost object
- ✓ **If not directly traceable** - it shall be assigned to various cost objects based on benefits received.

7. Presentation: Quality control cost should be presented as a separate line item in cost statements, if material

8. Disclosures: Entity should disclose the following as part cost statement or foot note or special schedules only if material or significant

- **Basis of distribution:** The basis of distribution of Quality Control cost to the cost objects/cost units.
- **Quantity and Rates:** Quantity and Cost of resources used for Quality Control cost as applicable.
- **Related party transactions:** Quality Control cost paid/ payable to related parties.
- **Forex:** Quality Control cost incurred in foreign exchange.
- **Abnormal cost:** Any abnormal portion of the Quality Control cost.
- **Penalties:** Penalties and damages excluded from the Quality Control cost.
- **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the pollution control cost should be made only if,
 - it is required by law or
 - for compliance with the requirements of a cost accounting standard, or
 - A change would result in a more appropriate preparation or presentation of cost statements of an organization.

CAS 22- MANUFACTURING COSTS

1. Introduction.

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

2. Objective:

- is to bring uniformity and consistency.
- in the principles and methods of
- determining the Manufacturing Cost of excisable goods with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMAAPD** of **Manufacturing Cost of excisable goods** including those requiring attestation.

4. Definitions:

- Manufacturing Cost:
 - Manufacturing cost of an excisable goods
 - is the aggregate of costs of all resources used
 - in the process of its manufacturing

5. Principles of measurement:

- Product wise measurement:** Manufacturing cost for each excisable good shall be measured separately.
- Manufacturing cost:** It is aggregate of direct and indirect cost relating to manufacturing activity.
- Material cost:**
 - It shall be measured separately for each type of material.
 - Normal scrap/defectives shall be included in the material cost of excisable goods manufactured.
 - Realizable value of scrap or waste shall be deducted from cost of production.
 - Abnormal loss of materials net of realizable value should be treated as loss and should be charged off to profit and loss account.
- The following costs should be **measured separately for each excisable good**.
 - Employee cost
 - Cost of utilities
 - Packing material cost
 - Direct Expenses
 - Repairs and maintenance cost
 - Depreciation and Amortization cost
 - Research & Development cost
 - Further processing cost - for each joint or by-product.
 - Royalty and Technical Know-how Fee

- Paid in Lummus should be amortized based on estimated output or benefit.
- Royalty paid on sales shall not form part of manufacturing cost.
- Quality Control cost
- Manufacturing Overheads
- e. **Inclusions:** The following are included in manufacturing cost of excisable goods:
 - i. Cost of **inputs received free of cost** or at concessional value from the buyer of excisable good and
 - ii. **Amortization cost of free tools**, pattern, dies, drawings, blueprints, technical maps, charts, engineering, development, art work, design work, plans, sketches, and the like necessary for production of excisable goods.
 - iii. **Cost of rework**, reconditioning, retro fitment. Manufacturing Overheads and other costs allocable to such activity,
 - iv. adjustment for stock of work-in-process and recoveries from sales of scrap and wastages and the like necessary for production of excisable good.
- f. **Capacity:**
 - The manufacturing cost of excisable good shall be determined based on the normal capacity or actual capacity utilization whichever is higher and
 - unabsorbed cost, if any, shall be treated as abnormal cost
- g. **Exclusions:** The following should be excluded in computation of manufacturing cost.
 - Subsidy/Grant/Incentive or any such payment received/receivable
 - Fines, penalties, damages, demurrage and similar levies paid to statutory authorities or other third parties.
 - Foreign exchange rate fluctuations after the date of import.
 - Credits/recoveries relating to the manufacturing cost
- 6. **Assignment of Cost:**
 - If **directly traceable to a cost object** - shall be assigned to that cost object
 - If **not directly traceable** - it shall be assigned to various cost objects based on any of one of the following bases.
 - Cause and Effect
 - Benefits received.
 - **Variable production overheads** - be absorbed based on actual production.
 - **Fixed production overheads** - on the basis of the normal capacity or actual of the plant, whichever is higher.
 - **Joint and by-products:**
 - i. **Joint products** - allocated between the products on a rational and consistent basis
 - ii. **by-products**- Net realizable value of by products is credited to the manufacturing cost of the main product.
 - iii. **Miscellaneous Income:** shall be adjusted in the determination of manufacturing cost.
- 7. **Presentation:** Cost statement shall present following information

- Actual capacity utilization in absolute terms and as a percentage of normal capacity.
- Cost Information relating to various elements of Cost shall be presented separately.

8. Disclosures

- a. Disclosure shall be made only where material, significant and quantifiable.
- b. If there is any change in cost accounting principles and practices
 - during the period under review which may materially affect the manufacturing cost of excisable good
 - in terms of comparability with previous period(s), the same shall be disclosed.

CASA 23- OVERBURDEN REMOVAL COST

1. Introduction:

- This standard deals with the principles and methods of
- measurement and assignment of Overburden Removal Cost
- and the presentation and disclosure in cost statements.

2. Objective:

- is to bring uniformity and consistency.
- in the principles and methods of
- determining the Overburden Removal Cost with reasonable accuracy.

3. Scope:

This standard shall be applied to cost statements which require **CMA PD** of **Overburden Removal Cost** including those requiring attestation.

4. Definitions:

- a. **Overburden:** It is the overlying materials generally having no commercial value.
- b. **Overburden Removal cost:** it refers to cost incurred to remove the overlying material from the mine site.
- c. **Stripping Activity:** It is the activity of overburden removal that benefits the identified component of an ore to be mined by the entity.
- d. **Stripping Ratio:** Stripping ratio is ratio of excavation of overburden to ore.
- e. **Standard stripping ratio:** This is the ratio between the total quantity of overburden to be removed (in cubic meters) and the total mineral to be extracted (in tonnes) during the Projected life of the project.
- f. **Advance Stripping:**
 - Advance Stripping is the excess overburden removed in between the overburden bench and
 - assumed angle of repose drawn from the starting of Mineral bench from the surface of Mineral than what is needed for extraction of Mineral.

5. Principles of Measurement

- **Overburden Removal Cost:** It is aggregate of direct and indirect cost. Relating to overburden removal activity.

- **Direct cost:** It includes.
 - cost of consumable stores, spares like machinery spares, explosives and
 - detonators, manpower, equipment usage, utilities, payment made directly to contractors and
 - other identifiable resources consumed in such activity.
- **Indirect cost:** It includes the
 - cost of resources common to various mining operation including overburden removal activity
 - such as manpower, administrative overheads, loading and unloading equipment usage and other costs allocable to such activities.
- **Development phase:**
 - OBR Cost relating to the development phase of a mine area shall be capitalized as non-current asset.
 - when it is probable that future economic benefits to the area will flow to the entity and
 - such cost can be identified and measured separately.
- **OBR Cost of developed Area of mine** - shall be charged to production of ore at the Standard stripping ratio.
- **Measurement of Overburden:**
 - It shall be measured by multiplying the number of trips undertaken by equipment for Overburden removal or by any electronic mode.
 - Measurement at regular intervals may be carried out by volume/ physical verification to arrive at fair quantity of overburden removed.
 - Final assessment will be made based on scientific methodology.
- **Current ratio** = Actual overburden removed / Actual production of mineral
- **Removal by outside party:**
 - Cost of overburden removal activity carried out by outsourcing shall be determined at agreed price as per contract price.
 - including duties and taxes and other expenditure directly attributable thereto.
 - The cost shall also include the cost of resources provided to the contractor by the company
- **Measurement by mine:** Cost of overburden removal activity of each mine shall be computed and considered separately.
- Overburden removal cost shall **not include** the following:
 - Subsidy/ grant/ incentive or amount of similar nature received/ receivable.
 - Abnormal overburden cost relating to abnormal circumstances.
 - Fines, Penalties, damages paid to statutory authorities and third parties.
 - Interest and finance charges
- **Changes in Accounting principles:** Changes in the cost accounting principles applied for the measurement of the pollution control cost should be made only if
 - it is required by law or

- for compliance with the requirements of a cost accounting standard, or
- a change would result in a more appropriate preparation or presentation of cost statements of an organization

6. Assignment of costs:

- **Direct cost** - shall be assigned to the overburden removal activity.
- **Equipment Cost** - Shall be assigned in the ratio of machine hours actually engaged for mineral and overburden removal or any other appropriate method.
- **administrative overheads and other indirect expenses** - ratio of actual mineral produced and overburden removed.

7. **Presentation** - Overburden removal, absorption and cost details shall be presented separately for each mine.

8. **Disclosures:** Entity should disclose the following as part cost statement or foot note or special schedules only if material or significant.

- **Basis:** The basis of determining the overburden removal cost.
- **Standard Cost:** If cost of removal is considered at standard ratio, variations positive or negative from the current ratio should be disclosed.
- **Subsidy:** Any subsidy grant/ incentive and any such payment reduced from the cost of overburden removal
- **Credits:** Credit/ recoveries relating to overburden removal.
- **Abnormal Cost:** Any abnormal cost excluded from overburden removal cost
- **Penalties:** Penalties and damages excluded from the overburden removal Cost

EAS 24 TREATMENT OF REVENUE IN COST STATEMENTS

1. Introduction:

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

2. Objective.

- is to bring uniformity and consistency.
- in the principles and methods of Scope
- determining the Revenue with reasonable accuracy

3. Scope

This standard shall be applied to cost statements which require **CMAPD** of Revenue including those requiring attestation.

4. Definitions:

- **Net Sales Realization:** It is revenue from operations net of discounts and Indirect taxes.
- **Other Income:** It is the income that cannot be classified as revenue from operations,
- **Revenue:** The term Revenue will have the same meaning as assigned in the Accounting Standards.

- **Revenue from operations:** It is the income arising in the course of the ordinary activities of an entity from the sale of goods or rendering of services.

5. Principles of Measurement

a. Measurement of Revenue:

- Revenue from sale of goods or provision of services shall be measured based on the net sales realization
- Revenue from sale of each **joint products** measured separately.
- Revenue from sale of goods or services measured for each location separately.
- Revenue for each type of by-product, defectives, sub-standard products etc should be measured separately.
- The net realizable value of by-product should be reduced from total joint cost and balance joint cost should be applied for main product.
- The Net scrap value of defectives, rejects, scrap etc should be reduced from cost of production.
- If input or intermediate products etc is sold outside, then its sales value should be netted off from cost of purchase or production cost of such input or intermediate product.

b. **Other income:** It shall not be considered in determining profit or loss as per cost accounts

c. **CSR:** Revenue generated from utilization of assets created under the CSR program shall not be considered in determining profit or loss as per cost accounts

d. **Subsidies:**

- Product or service-related subsidies, grants, or incentives, received or receivable
- on sale of goods or rendering of services
- shall be part of revenue from operations and
- shall be identified with each product sold or service rendered.

e. **Capital Subsidy:**

- Any subsidy, grant, incentive or any such payment received or receivable to support the current operations of the entity other than those in the nature of capital grant
- shall be treated as reduction in the related cost

f. **Change in the cost accounting principles:** applied for the determination of revenue shall be made only

- if it is required by law or regulations or
- for compliance with the requirements of a cost accounting standard or
- the change would result in more appropriate preparation or presentation of cost statements of an entity.

6. Assignment of Revenue:

Revenue for each type of product or service shall be **assigned directly product or service** to the extent it is economically feasible.

7. Presentation:

a. Sales realization:

- Net sales realization for each product or service shall be indicated separately for exports, domestic sales, manufactured goods, operations, and trading activities and
- matched against the cost of sales (net of duties) and
- margin of respective product or service

b. Quantity and Price:

- The quantity of goods sold or services provided and
- Selling price per unit shall be presented under each product or service

8. Disclosures: The following disclosures shall be made in the body of the cost statements or as a foot note or as a separate schedule, only if material or significant.

a. The cost statements shall disclose the following

- **Related Party Transactions:** Revenue from sale of goods or services made to each related party with basis of determining the selling price
- **By-Products:** Revenue from by-products and costs of further processing after split-off point, reduced from cost of relevant product.
- **Nature of Subsidy:** Amount and nature of any subsidy, grant or incentive received or receivable and included in the revenue.

b. Changes in Accounting Policies:

- Any change in the cost accounting principles and methods applied for the measurement and assignment of revenue during the period covered by the cost statement.
- which has a material effect on the revenue shall be disclosed.
- Where the effect of such change is not ascertainable, wholly or partly, the fact shall be indicated.

GUIDANCE NOTES ON COST ACCOUNTING STANDARDS

1. Introduction:

- **Who issue:** The Institute of Cost Accountants of India is empowered to issue guidance notes on CAS to facilitate better understanding and application of the same in record maintenance and audit procedure.
- **Areas of issue of GN:**
 - Guidance notes are issued on standards dealing with specific cost elements.
 - Guidance notes may also be issued on standards with specific purpose.
- **Coverage:** Guidance notes deal with
 - Principles and methods covered in CAS
 - Practical aspects with respect to subject matter of CAS
- **No of GN:** Till date 13 guidance notes on various issues were issued by ICAI.

List of Guidance Notes

Overview of Cost Accounting Standards and GACAP

GN 01	GN on Capacity determination (CAS 02)
GN 02	GN on Cost of production for captive consumption (CAS 04)
GN 03	GN on Material Cost (CAS 06)
GN 04	GN on Employee Cost (CAS 07)
GN 05	GN on Cost of utilities (CAS 08)
GN 06	GN on Cost of Packing Material Cost (CAS 09)
GN 07	GN on Direct expenses (CAS 10)
GN 08	GN on Administrative Overheads (CAS 11)
GN 09	GN on Repairs and Maintenance Cost (CAS 12)
GN 011	GN on Maintenance of Cost Accounting Records for Construction Industry Including Real Estate and Property Development Activity
GN 011	GN on Treatment of Costs Relating to Corporate Social Responsibility Activities
GN 012	GN on Cost-of-Service Cost Center (CAS-13)
GN 013	GN on Compilation Engagements by a Cost Accountant

Generally accepted Cost Accounting Principles (GACAP)

- **Introduction:** The cost records of an entity should be maintained
 - in accordance with the GACAP and
 - CAS issued by the ICAI to the extent these are found to be relevant and applicable.
 - The variations, if any, are to be clearly indicated and explained
- **Objectives:** The following are the various objective behind issue of GACAP.
 - To **codify** the GACAP
 - To narrow down diversities in cost accounting practices
 - To provide a reference source to industry and practitioners in preparation and attestation of Cost Statements
 - To facilitate stakeholders in understanding and interpreting the cost statement
 - To provide a base for monitoring the evolution of new concepts and practices in cost accounting.
- **Scope:**
 - ✓ The scope is to codify the cost accounting principles to be followed by business and other entities in India in preparing and presenting cost information more particularly the General-Purpose Cost Statements covered by Cost Audit
 - ✓ This document also encompasses the generally accepted cost accounting practices presently being followed by such entities.
- **Conceptual Frame Work:**
 - It is a framework which helps to understand.
 - ✓ the GACAP which is followed by industry in India, in the appropriate perspective

and

- ✓ guides in modifying them or developing new principles

➤ **Focus on drivers of value:**

- Knowledge of Costing is a pre-requisite for exercising an informed decision making regarding.
 - Drivers of cost.
 - Revenue,
 - Profits and
 - Value
- Costing has to fulfil this role both in a historical and in a forward looking context

➤ **Cost for a purpose:**

- Costs which are relevant for decision making varies depending upon circumstances and purpose.
- Same set of cost data may not fulfil different purposes of decision making

➤ **Reality Driven:**

- Cost models must reflect the entity's business model, its operational processes, its strategy, its organizational structure and its competitive environment.
- Organizational processes and activities drive the costs and these are in turn influenced by other factors.

➤ **Materiality and cost effectiveness:**

- The selection of the methods of implementing the costing principles should have regard to the issues of materiality and cost effectiveness.
- Materiality of cost information is to be judged from the perspective of the user of that information.

➤ **Comparability and consistency:**

- Cost information should be prepared and presented in a way which provides for comparability over time and consistency.
- The methods used for preparing and presenting cost information should be changed only where for valid reasons such as those required by law. compliance with new cost accounting standards or on the grounds that it would result in a more appropriate presentation of cost information.

➤ **Transparency and auditability**

- Cost information is used generally by various stakeholders like management, regulators and Government with a business outlook, there is a need for transparency regarding the definitions used and sources of data.
- It should be possible for those who wish to review such cost information to follow an audit trail. Auditability of cost information is a prerequisite to the effective use of such information.

Overview of Cost Accounting Standards and GACAP

Illustration 1

Burnet Ltd., a manufacturing unit, provides the following extracts from its records for the year ended March 31, 2022:

The Company's specifications capacity for a machine per hour	1,500 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	12 days
Annual maintenance is done within these holidays	—
Preventive weekly maintenance for the machine is carried on during Sundays	
Normal idle capacity due to lunchtime, shift changes etc. per shift	1 hour
Production based on sales expectancy in past 5 years (units in lakh):	75.70
	87.42
	65.38
	77.97
	76.08
Actual Production for the year (units in lakh)	81.50

You are required to calculate:

- Installed Capacity
 - Practical Capacity
 - Actual Capacity (%)
 - Normal Capacity
 - Idle Capacity (%)
 - Abnormal Capacity
- Keeping in view of the relevant Cost Accounting Standard (CAS-2)

Illustration 2

The following information pertains to REACON CEMENT LTD., a manufacturing cement company for the year that ended as follows:

The year ended March 31	2021-22	2020-21
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

Overview of Cost Accounting Standards and GACAP

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 suggestions for improvement

Illustration 3

The following data have been available of Sunflag Dolon Limited:

	2019 - 20	2020 - 21	2021 - 22
Installed Capacity—Ton	250	250	250
Production—Ton	240	230	125
Cost Per Ton (₹)	1,000	1,077	1,660

The poor capacity utilization in 2021-22 was due to abnormal power-cut. The escalation in costs were 5% in 2020-21 and 7% in 2021-22 based on 2019-20

- i) Calculate abnormal cost due to power cut
- ii) How would you treat abnormal cost?

Illustration 4

GLORY LTD., a manufacturing company provides the following extracts from its Cost Accounting Records for the year ended March 31, 2022

The total capacity for 5 Machines per hour as per the company's specification.	2500 Units
No. of shifts (each shift of 8 hours) per day	3
Paid holidays in a year (365 days):	
(i) Weekly holidays	52
(ii) Other holidays	10
Annual maintenance is done within these holidays (i.e. 10)	

Overview of Cost Accounting Standards and GACAP

Preventive maintenance for the machines is carried on during weekly off day.	
Normal idle capacity due to lunchtime, shift changes etc. per shift	0.5 hour
Production based on sales expectancy in past 3 years (units in lakh):	154.50
	159.54
	166.66
Actual production for the year ended March 31, 2022:	158.80

Your required to calculate

- Installed capacity
- Practical capacity
- Actual capacity
- Normal capacity
- Idle capacity
- Abnormal capacity ----keeping in view of relevant CAS-2

Illustration 5

A plant operates 3 shifts of 8 hours each for all days except Sundays and 8 holidays. Preventive maintenance is taken care in Sundays and annual maintenance in 8 hoildays. Normal idle time for food, shift change and other work for the workers is 1 hour per shift. Installed Capacity of the machine = 1200 units per hour. Production during last 5 years & Current year are 69.4, 72.6, 71.4, 70.5, 70.8, 69.9 lakh units Determine according to CAS-2, installed capacity, actual capacity, idle capacity, abnormal idle capacity.

Illustration 6.

The following particulars pertaining to production of yarn are extracted from the records of Balarampur Textiles Ltd. for the year ended March 31, 2022:

Particulars	₹ '000
Direct Material Cost per unit	2,560
Direct Wages & Salaries	1,540
Direct Expenses	450
Indirect Materials	533
Factory Overheads	897
Administrative Overheads (40% relating to Production activities)	1,250
Quality Control Cost	565
Research and Development Cost	600

Overview of Cost Accounting Standards and GACAP

Interest on Working Capital	350
Sale of Scrap Realised	460

You are to determine the cost of production for the purpose of captive consumption in terms of the Rule 30 of the Central Goods & Services Tax Rules 2017 and as per the CAS-4 (Revised) and the Assessable Value for the purpose of paying GST on applicable transactions.

Illustration 7.

ABUNA ELECTRONICS LTD. is engaged in the manufacture of LED TV sets having its factories at Patna and Gujarat. The company manufactures picture tube at Patna which is consumed to produce LED TV sets at Gujarat factory. The following information pertaining to captively consumed picture tubes are extracted from the records of the company for the half year ended March 31, 2022.

	(₹ in Thousand)
Direct material	950
Direct wages and salaries	357
Direct expenses	80
Indirect materials	70
Factory overheads	320
Administrative overheads (20% relating to production activities)	640
Quality control cost	100
Research and development cost	125
Selling and distribution expenses	225
Sale of scrap realized	130
Profit margin	15%

You are required to determine:

- The cost of production for purpose of captive consumption in terms of Rule 30 of the Central Goods & Services Tax Rules 2017 and as per CAS-4 (Revised), and
- Assessable Value for the purpose of paying GST on applicable transactions.

Illustration 8.

Purchase of Materials ₹ 3,00,000 (inclusive of GST of ₹ 15,715); Free on Board ₹ 12,000; Import Duty ₹ 15,000; Freight inward ₹ 20,000; Insurance paid for import by sea ₹ 10,000; Rebates allowed ₹ 4,000; Cash discount ₹ 3,000; Subsidy received from the Government for importation of these materials ₹ 20,000. Compute the landed cost of material (i.e. value of receipt of material).

Illustration 9.

Purchase of Materials \$ 50,000 [Forward contract rate \$ = ₹ 64.40 but \$ = ₹ 64.60 on the

Overview of Cost Accounting Standards and GACAP

date of importation]; Import Duty paid ₹ 5,65,000; Freight inward ₹ 1,62,000; Insurance paid for import by road ₹ 48,000; Cash discount ₹ 33,000; Payment made to the foreign vendor after a month, on that date the rate of exchange was \$ = ₹ 65.20. Compute the landed cost of material.

Illustration 10.

Opening stock of raw materials (5,000 units) ₹ 1,80,000; Purchase of Raw Materials (17,500 units) ₹ 7,00,000; Closing Stock of Raw Materials 3,500 units; Freight Inward ₹ 85,000; Self-manufactured packing material for purchased raw materials only ₹ 60,000 (including share of administrative overheads related to marketing sales ₹ 8,000); Demurrage charges levied by transporter for delay in collection ₹ 11,000; Normal Loss of materials due to shrinkage in transit 1% of materials purchased; Abnormal Loss due to absorption of moisture before receipt of materials 100 units. Calculate the value of Closing Stock (Average Cost Method).

Illustration 11.

A Steel Company which produces Iron Casting Pipes and rod iron is covered under the Cost Audit according to the Companies (Cost Records and Audit) Rules 2014. From the expenditure data relating to 2021-22, determine the employees cost according to CAS -7.

Illustration 12.

A manufacturing firm has up its own power plant to cater its need in manufacturing process. Its one month data is given below :

Number of units produced = 100 lakh units of which 5% is used by generating unit. Material and utility used:

- (i) Coal 300 MT @ ₹ 30,000 per MT
- (ii) Oil 5 MT @ ₹ 1,60,000 MT
- (iii) Cost of Water extraction and treatment: 6 lakh litres @ ₹ 3 per litre
- (iv) Steam boiler cost ₹ 55 lakh with residual value 5 lakhs after life of 10 years.
- (v) Cost of Generating Plant is ₹ 90 lakhs with no residual value. Depreciation is charged on straight line method @ 10%
- (vi) Generating Plant: 100 skilled workers @ ₹ 30,000 & 150 helpers @ ₹ 20,000 pm.
- (vii) Boiler plant: 60 semi-skilled workers @ ₹ 25,000 & 100 helpers @ ₹ 20,000 pm
- (viii) Repair & Maintenance of generating plant & Boiler is ₹ 5.0 lakhs
- (ix) Share of Administrative charges ₹ 20 lakh
- (x) Realization from Sale of ash disposed is ₹ 1.5 lakh

Prepare a cost sheet for electricity generating cost and calculate cost per unit

Overview of Cost Accounting Standards and GACAP

Illustration 13.

During the Energy Audit of Reliable Engineering Ltd., the following figures relating to usage of power were placed before the Auditor:

	2021-22	2020-21	2019-20
Total Power consumed (kWh)	2642720	2744360	2393250
Rate per kWh (₹)	6.29	5.42	4.90
Total Production (in million kg.)	422.16	416.36	376.08

Compute the necessary productivity measures and (i) Price Variance and (ii) Volume Variance of power usage during these years.

Illustration 14.

TROMA LTD., a manufacturing unit, produces two products PB and PS. The following information is extracted from the Books of the Company for the year ended March 31, 2022:

Particulars	Product PB	Product PS
Units Produced (Qty.)	2,10,000	1,68,000
Units sold (Qty.)	1,68,000	1,36,500
Machine hours utilized	1,26,000	84,000
Design charges (₹)	1,57,500	1,89,000
Software development charges (₹)	2,62,500	3,78,000

Royalty paid on sales ₹ 6,09,000 [@ ₹ 2 per unit sold for both the products].

(i) Royalty paid on units produced ₹ 3,78,000 [@ ₹ 1 per unit produced for both the products].

(ii) Hire charges of equipment used in the manufacturing process of product PB only ₹ 53,000.

Note: No adjustments are to be made related to units held i.e. Closing Stock.

You are required to compute the Direct Expenses—keeping in view of Cost Accounting Standard (CAS- 10).

Illustration 15.

Standard Material requirement to produce 1000 units of product X is 1200 units of material at a standard price of ₹ 60 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 ₹ 20 per unit. Scrap units can be sold at ₹ 5 per unit.

During a particular period, units produced were 19500 with 24000 units of materials at

Overview of Cost Accounting Standards and GACAP

BCCA

standard cost of ₹ 60 per unit, 7000 units were rejected out of which 2500 units were reworked at a cost of ₹ 51,000. The balance units were sold as scrap for ₹ 5 per unit. Calculate Material Quality Variance and Scrap Variance.

COST AUDITING AND ASSURANCE STANDARDS

Introduction:

- As per Sec 148 (3) Cost Auditor conducting the cost audit shall comply with all applicable cost auditing standards issued by Institute of Cost Accountants of India.
- CAASB-Cost Audit and Assurance standards board develops cost audit standards.
- CAASB in development of CAAS takes into consideration the following:
 - ✓ Applicable laws o Usage
 - ✓ business environment prevailing in India
 - ✓ ICAI rules and regulations
 - ✓ Code of Professional Ethics
 - ✓ Cost Accounting Standards and other Statements issued by ICAI
- Any CAAS issued by ICAI is inconsistent with any law, then law will prevail.
- List of Cost Audit standards issued by ICAI with approval of central government:
 - ✓ CAS 101-Planning an audit of Cost Statements
 - ✓ CAS 102-Cost Audit Documentation
 - ✓ CAS 103 - Overall objectives of the independent cost auditor and the conduct of an Audit in accordance with Cost Auditing Standards
 - ✓ CAS 104-Knowledge of business, its processes and the business environment

CAS 101 – planning an audit of Cost Statements

1. Introduction:

- Planning an audit of cost statements, records and other related documents is considered necessary.
- to ensure achievement of audit objectives with available resources and
- securing coordination with the auditee on audit work.

2. Objective:

- Is to guide the members in planning for the audit of cost statements so that it is performed in an efficient and effective manner.
- Audit planning include establishing the overall audit strategy.

3. Scope:

- It deals with the auditors' responsibility to plan an audit of cost statements, records and other related documents.
- The auditor shall prepare and document the overall audit strategy and audit plan.

4. Definitions:

✓ Audit:

- It is an independent examination of financial, cost and other related Information of an entity
- Whether profit oriented or not,
- irrespective of its size or legal form,
- when such an examination is conducted with a view to expressing an opinion thereon.

✓ **Audit Plane:**

- A record of the planned nature, timing and extent of risk assessment procedures and
- further audit procedures at the assertion level
- in response to the assessed risks

✓ **Audit Risk:**

- It is the risk that the cost auditor expresses an inappropriate audit opinion on the cost statements that are materially misstated.
- Audit risk is a function of the risk of material misstatement and detection risk.

✓ **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.

✓ **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 entity's internal, operational and management control.

✓ **Detection risk:**

- The risk that the procedures followed by the cost auditor to reduce audit risk to an acceptable low level
- will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

✓ **Cost Audit:**

- It is an independent examination of cost statements, cost records and other related information of an entity including a non-profit entity.
- when such an examination is conducted with a view to expressing an opinion thereon

✓ **Misstatement:**

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

✓ **Overall Audit Strategy:** it sets out

- the scope,
- timing
- direction of the audit, and
- guides the development of the detailed audit plan

✓ **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, costheads and disclosure thereof.

5. Requirements:

- a. **Matters to be inquired before planning:** Cost Auditor has to ensure the following before starting the planning phase.
 - his appointment as cost auditor is proper
 - whether ethical requirements as per the regulations continue to be satisfied i.e.
 - auditor should not engage in development of Cost Accounting system etc for the client.
 - No compromise regarding integrity of management.
 - an understanding of the terms of reference to audit engagement.
- b. **Audit team engage in planning:**
 - Audit partner and other team members should participate in audit planning.
 - Experiences and insights all members will be considered, to enhance effectiveness and efficiency of planning process.
- c. **Overall audit strategy:** Auditor should formulate overall audit strategy including audit plan setting out scope, timing and direction of audit by considering the following factors, and update it as per requirement during the course of audit.
 - results of preliminary activities
 - knowledge from previous audits and other engagements with the client
 - knowledge of client business
 - nature and scope of the audit
 - statutory deadlines and reporting format
 - factors determining the direction of the audit efforts.
 - nature, timing and extent of resources required for the audit
 - requirements from audit by industry regulator's regulations.
 - Reliance that can be kept on work performed by other auditors and experts
 - Statutory timelines for cost audit reporting
 - ERP used by the client and degree of reliance that can be kept on it.
- d. **Documentation:** Auditor should document the following with respect to planning of audit.
 - Overall audit strategy
 - Audit plan
 - Significant changes made during the audit along with reasons for such changes.
- e. **Initial audit engagements:** Auditor should consider the following additional matters while planning for initial audit engagements.
 - Communication with the previous auditors and review of previous years audit working papers, if not prohibited otherwise.
 - Major issues discussed with management with respect to selection of cost auditor.
 - Obtain sufficient and appropriate audit evidence with respect to opening balances.

CAS 102 – Cost Audit Documentation

- **Purpose:** The purpose of this Standard is to provide guidance to the members in preparation of Audit Documentation in audit of cost statements, records and other related documents.

- **Objective:** To guide the members to prepare documentation to provide
 - ✓ sufficient and appropriate record which acts as a base for Cost Auditor's Report and
 - ✓ Act as evidence that the audit was planned and performed in accordance with CAS and applicable legal & regulatory requirements.
- **Scope:**
 - ✓ It deals with responsibility of cost auditor to prepare documentation for cost audit
 - ✓ Documentation requirements specified in other CAS cannot restrict scope this standard.
 - ✓ Applicable laws or regulations may provide for additional documentation requirements.
- **Definitions:**
 - ✓ **Audit Documentation:** It refers to records including working papers prepared or obtained and retained by the Cost auditor in connection with the performance of the audit.
 - ✓ **Audit working papers:**
 - Refers to any documents on which evidences obtained during the course of cost audit is recorded.
 - Working papers acts as evidence that cost audit was performed in accordance with all applicable CAS and other applicable rules and regulations.
 - **List of documents:** Cost audit documentation consists of the following items.
 - Checklists
 - Audit programs
 - Analysis
 - Audit query list
 - Abstracts of significant contacts relating cost and revenues
 - Confirmation letters
 - Copies of entities records
 - **Content and Form of documentation:** It may be physical form or electronic form. The following factors will influence content and form of audit documentation.
 - ✓ size and complexity of the operations
 - ✓ extent of computerization of cost records
 - ✓ assessed risks of material misstatement
 - ✓ cost audit methodology and tools used
 - **Sufficiency:** Audit documentation should be sufficient and appropriate.
 - **Property of Cost Auditor:** The audit documentation is the property of the Cost Auditor. Auditor is not required to allow them to any one including the client unless It is required by law or regulation or at his discretion.
 - **Retention period:** Cost Audit Documentation should be retained for at least ten years from the date of the Cost Audit Report by the auditor.

CAS 103 Overall objectives of the independent cost auditor and the conduct of an Audit in accordance with Cost Auditing Standards

COST AUDIT PROGRAMME

Introduction:

A cost accountant in practice should observe certain principle in planning and performing the cost audit in hand.

- The work should be planned with professional care recognizing that circumstances may exist to cause the cost statements to be materially mis-stated.
- Therefore, the audit assignment should be so programmed to provide reasonable assurance that the cost information provided is free of material misstatements.

Factors in planning cost audit assignment

In planning the audit assignment certain important factors are taken into consideration viz.

i. Audit personnel for the assignment:

- a. Relevant experience and training are important criteria to be used in selection of audit personnel.
- b. The cost audit needs appropriate direction and supervision to accomplish the following tasks:
 - Physical inspection of the assigned activities and cost accounting records.
 - Knowledge of the key personnel who are in-charge for the maintenance of cost records.
 - Ability to understand budgets, plans and strategies relating to activities.
 - Ability to understand Cost Accounting system followed by the client and knowledge of CAS used in the preparation of cost statements.
- c. The audit personnel should be asked to collect the documentary evidence for the above tasks and file in the relevant cost audit file for future reference.

ii. Documentation of the audit procedures and of evidence:

- a. The cost auditor should document important matters which will act as evidence for the opinion expressed in audit report.
- b. Documentation refers to the working papers prepared by and for, or obtained and retained by the cost auditor in connection with the performance of the audit or compliance function.
- c. Cost audit team should follow appropriate procedures.
 - For maintaining the confidentiality of and safe custody of the working papers and
 - For retaining them for a period sufficient to meet the needs of the practice and in accordance with legal and professional; requirements of retention of records.
 - **Quality control exercised over performance of the assignment etc.** The

personnel carrying out these responsibilities generally perform the following functions during the course of audit.

- Monitoring the progress of the maintenance of cost accounting records,
- Reviewing skills and competencies of audit team members.
- Consideration of questions raised during the course of audit and revising audit plan and programme.
- Removing the differences of professional judgement between the personnel and deciding the level which is appropriate for reference purpose.

CHECKLIST TO AUDIT VARIOUS COST ELEMENTS:

- Audit of Production- Product wise:** Following checklist should be considered to audit production-product wise:
 - Ensure that there is proper inventory balancing for each of the finished product. For example. $\text{Opening Stock} + \text{Production} - \text{External Sales} + \text{Internal Transfers} = \text{Closing Stock}$
 - Ensure that closing stock of previous year is correctly considered as opening stock of current year
 - Check the capacity utilisation of previous 5 years-product wise
 - For any abnormal under utilisation of production capacity the auditor should seek the reasons from the management and what steps management has proposed to undertake to overcome under utilisation of capacity.
 - Check whether there is any circumstance where there is addition to capacity for any product during the year but actual production achieved is either equal to or less than that of previous year. Reasons for the same should be sought from the management.
- Audit of Raw Material Cost:** Following checklist should be kept in view to audit raw material cost during cost audit:
 - Ensure that proper quantitative inventory balancing is carried out for all the raw materials, for example. $\text{Opening Stock} + \text{Purchases} - \text{Consumption} = \text{Closing Stock}$
 - Work out Input/Output Ratios for key raw materials for previous 3 to 5 years. Least of these 3 to 5 years Input/Output Ratio can be considered as Bench Mark Input/Output Ratio.
 - In case of chemical based industries, some chemicals tend to evaporate during their storage. Being normal loss, it should be shown as consumption for that product. In case of multiple products, this normal loss need to be appropriated among products based on consumption quantity
 - If R&D Department has carried out some process improvement for reducing the

consumption of some key raw material then it needs to be checked how much raw material.

Consumption has reduced

- e. For charging raw material cost to product/products, both FIFO & Weighted Average rates can be applied. A company can follow any method but it needs to be ensured that it is applied consistently.
- f. Usually, a company prepares expense control chart where raw material is shown by different cost centres like production cost centres and utilities cost centres like filtered water, DM water, boiler, cooling water etc. The total of all these cost centres should agree with total raw material consumption as per Trial Balance
- g. If some raw material is produced in-house, then the company would have created separate cost centre for that raw material. So its valuation should be done as per costs which are booked against this cost centre.
- h. Sometimes it may happen that both imported & local raw materials are used in various products. In such case it is prudent to show consumption of both imported & local raw materials in the same proportion in all the products to avoid distortion of that particular raw material cost in various products
- i. Similarly, it may happen that both local & self manufactured raw materials are used in various products. In this case also it is better to show consumption of both local & self manufactured raw materials in the same proportion in all the products to avoid distortion of that particular raw material cost in various products.
- j. Sometimes a company may keep rented storage tank at port to store the material which is subsequently brought to the company premises. This rent will form part of cost of material
- k. R & D department can carry many innovations for utilizing alternative cheaper materials without compromising on quality of output
- l. Demurrage or detention charges or any penalty levied should not form part of landed cost of raw material
- m. Examine if all the specifications and features of the product, some of which are causes for this extra spoilage, are really necessary and if insisted upon then they are paid for by the customer
- n. Ensure that at the end of the year all raw materials dispatched by suppliers through the public or private carriers where ownership of goods has been passed on to the company are shown either in transit or as receipts
- o. Check that the opening balance is correct after adjustment of results of physical stock verification. Similarly closing balances should be checked to ensure that adjustments

- on stock verification have been carried out
- p. Check up whether all the receipts have been correctly valued after taking into account freight and other incidental charges
 - q. Statement of over-usage of raw materials should be prepared regularly and it should be given to concerned departmental head for necessary action
 - r. R&D department should suggest how to reduce/eliminate wastages
- iii. **Audit of Key Raw Material Inventory Status:** Following list of control points should be kept in view for audit of key raw materials representing significant inventory value.
- a. Obtain information about current stock position
 - b. Assess how the stock position is keeping pace with consumption pattern
 - c. Check whether unnecessary increase in the volume of inventory results in more and more cost locked up in inventory.
- iv. **Audit of Electricity Cost:** Following checklist should be kept in view to audit electricity cost during cost audit:
- a. Any increase in consumption without any corresponding requires explanation from the management as it is a matter of concern
 - b. Check the trend of electricity cost for previous 5 years
 - c. Check whether proper meters are installed increase in output
 - d. Check whether meters are regularly calibrated
 - e. Monthly report showing cost center wise allocation of electricity as submitted by electrical department should be the basis for ascertainment of cost center wise/product wise electricity cost
 - f. A company may have more than one source of electricity. Therefore,
 - g. Check that optimum electricity is procured from the cheaper source
- v. **Audit of Cost of Electricity Generated by DG set:** Following checklist should be remembered to audit the cost of electricity generated by DG set:
- a. Monthly report of Diesel Generating Set prepared by officer in-charge of DG set should be the basis for ascertainment of cost of electricity generated
 - b. Ensure that monthly report contains the following information:
 - c. No of hours DG set is operated
 - d. Quantity of high speed diesel used
 - e. Total units generated
 - f. Proper meters should be in place to quantify the total units generated and units allocated to various cost centres.
 - g. Meters should be regularly calibrated
 - h. There should be proper system to quantify quantity of diesel used

- i. Ratio of units (Kwh) generated to diesel used should be studied for previous 5 years
- j. Ensure that allocation of units to various cost centres are in line with the output of respective cost centres
- k. Ensure that employee cost is properly booked and it pertains to only those employees who are really employed for DG set and actually working for DG set
- l. Ensure that cost of consumable stores and repairs is properly allocated and it pertains to cost actually incurred for DG set
- m. Ensure the correctness of depreciation and insurance booked against DG set
- n. Ensure that proper cost centre is allocated to DG set
 - a. Generally, CMA Department prepares expense control chart which lists out all the expenses incurred for DG set and its allocation to various cost centres. The cost auditor should also go through this expense control chart
 - b. Cost auditor should ask for MIS report
- vi. **Audit of Dematerialized water cost:** Following checklist should be kept in view to audit demineralized water cost during cost audit:
 - a. Proper cost centre should be allocated to DM water plant
 - b. Monthly report prepared for demineralized water plant should form the basis for ascertainment of cost of demineralized water plant
 - c. Ensure that monthly report so prepared contains the following data:
 - Quantity of filtered water used
 - Quantity of chemicals used
 - Electricity units used (Kwh)
 - Quantity of demineralised water generated
 - Quantity of demineralised water allocated to production cost centres, boiler etc
 - d. There should be proper system in place to quantify quantity of demineralised water generated and quantity allocated to various cost centres
 - e. It is recommended to have proper meters which should be regularly calibrated
 - f. Ensure that quantity of DM water allocated to production cost centres and boiler are in line with output of respective cost centres
 - g. Ensure that employee cost allocated pertains only to those employees who are looking after DM water plant
 - h. Ensure that cost of consumables and repairs allocated to demineralised water plant actually pertains to DM water plant only. It should be ensured that expenses pertaining to other cost centres are not booked against DM water cost centre
 - i. Ensure correctness of depreciation and insurance
 - j. Cost of electricity should be as per work sheet prepared by CMA department

- k. Cost of chemicals consumed should be as per priced stores ledger
- l. Generally, company prepares expense control chart which shows compilation of element wise cost of DM water and its allocation to various cost centres. The cost auditor should collect and go through this expense control chart
- m. Ensure that cost sheet of DM water shows correct applicable cost of filtered water
- n. Cost auditor should ask for the MIS report
- vii. **Audit of steam cost:** Following checklist should be considered to audit steam cost during cost audit:
 - a. Generally, boiler house prepares monthly report which becomes the basis for ascertainment of cost of steam. Ensure that monthly report for boiler contains the following information:
 - Running hours of boiler
 - Quantity of steam generated (MT)
 - DM water consumption (KL)
 - Electricity consumption (Kwh)
 - Fuel consumption
 - Furnace oil, LSHS, Light Diesel oil, coal, Lignite etc.
 - Steam consumption in boiler auxiliary
 - Line losses
 - Steam consumed by manufacturing plants, labs etc.
 - b. The cost auditor should check the following ratios for previous 5 years:
 - i. Cost of steam generated for previous 5 years
 - ii. Quantity of steam generated per unit of fuel used
 - iii. Quantity of steam consumption in boiler auxiliary to total steam generated
 - iv. Quantity of line losses to total steam generated
 - v. Quantity of steam per MT of finished product
 - vi. Cost of steam per MT of finished product for previous 5 years
 - c. Proper steam meters should be in place to quantify steam generation and its allocation to various cost centres
 - d. Steam meters should be regularly calibrated
 - e. Line losses may be due to leakages in pipe lines. So all pipe lines should be properly insulated
 - f. Ensure that employees cost is correctly worked out and cost of only those employees is considered who are really employed for boiler house
 - g. Ensure that cost of consumable stores and repairs is properly booked against boiler
 - h. Ensure that depreciation and insurance are correctly worked out

- i. Cost auditor should go through steam cost of previous 5 years
- j. Generally CMA department prepares expense control chart which lists out all expenses for boiler and its allocation to various cost centre. The auditor can study this expense control chart
- viii. **Audit of Stores & Spares cost:** Following checklist should be kept in view to audit cost of stores & spares during cost audit:
 - a. **Information:** The cost auditor should obtain information from either CMA department/Finance department or through prevailing ERP system in the company. It provides at a glance year wise, cost centre wise expenses on stores & spares.
 - b. **Test Checking:** The cost auditor can pick up few major items of stores & spares and ensure that they have been booked against correct cost centres
 - c. **Under Capacity Utilisation:** The higher per MT expenses can be due to lower capacity utilization which he needs to highlight to the management
 - d. **Expense Control Chart:** The cost auditor should also go through expense control chart which shows plant wise expenses duly tied up with Trial Balance
- ix. **Audit of Repairs & Maintenance cost:** Following checklist should be taken into account to audit cost of repairs & maintenance during cost audit:
 - a. **Information Collection:** The cost auditor should obtain information from either CMA department/Finance department or through prevailing ERP system in the company. It provides at a glance year wise, cost centre wise expenses on repairs & maintenance.
 - b. **Test Checking:** The cost auditor can pick up few major items of repairs & maintenance and ensure that they have been booked against correct cost centres
 - c. **Under Capacity Utilisation:** Higher per MT expenses can be due to lower capacity utilisation which he needs to highlight to the management
 - d. **Expense Control Chart:** The cost auditor should also go through expense control chart which gives plant wise expenses duly tied up with Trial Balance
- x. **Audit of Employee Cost:** Following checklist should be kept in view to audit employee cost during cost audit. The Cost Auditor should verify the following:
 - a. **Cost Centre wise verification:** Employee cost, Number of employees and average cost per employee for previous 5 years-cost centre wise
 - b. **Product wise verification:** Employee cost, Number of employees, employee cost per MT and average cost per employee for previous 5 years - Product wise
 - c. **Increase in Employee Cost per MT:**
 - It may be due lower capacity utilisation.
 - It should be reported to the management of the entity.
 - d. **Updating of Employees List:** Cost Auditor should assess whether employee list is

regularly updated or not.

- e. **Employee Transfers:** Whether transfer of employees from one department to another is properly recorded and correctly reflected in pay roll or not.
- f. **Abnormal Increase in headcount:**
 - Cost Auditor should check whether employee count increased in any department abnormally.
 - Cost auditor should obtain appropriate reasons and justifications from the management for such abnormal increase.
- xi. **Audit of Insurance Cost:**
 - a. **Information:** Cost auditor should obtain information from concerned authority about various insurance policies taken and premiums paid by the entity.
 - b. **Types:**
 - Different types of insurance policies taken
 - Insurance premium paid by cost centre or product wise.
- xii. **Audit of Depreciation cost:** Following checklist should be considered to audit cost of depreciation during cost audit:
 - a. **Information:** The cost auditor should obtain information from concerned department in the company. It provides at a glance year wise, cost centre wise expenses on depreciation.
 - b. **Underutilization:**
 - i. The cost auditor should ask for information of expenses.
 - ii. Higher per MT expenses can be due to lower capacity utilisation which he needs to highlight to the management.
- xiii. **Audit of Administrative Overhead:**
 - a. The Cost Auditor shall obtain the following information.
 - i. Trend of administrative expenses by year and
 - ii. Administrative expenses by year and by product.
 - b. The Cost Auditor shall verify the correctness of the following:
 - i. Whether basis of allocation or apportionment of Admin Overheads to cost centres is inconsistent over a period of time.
 - ii. Whether any abnormal increase taken place any class of expense? If yes.
 - Obtain reasons for such abnormal increase
 - Collect cost centre wise information to analyse the reasons.
 - Present reasons to management
 - iii. Verify any donations and penalties are charged to products?
- xiv. **Audit of Selling and distribution overhead:**

- a. **Information:** The Cost Auditor should obtain the following information with respect to selling and distribution overheads.
 - i. Trend of selling and distribution expenses by Year.
 - ii. Amount Selling & distribution expenses by year and by product.
- b. **Verification:** The Cost Auditor shall verify the correctness of the following:
 - i. Whether basis of allocation or apportionment of Admin Overheads to cost centres is inconsistent over a period of time.
 - ii. Whether any abnormal increase taken place any class of expense? If yes
 - Obtain reasons for such abnormal increase
 - Collect cost centre wise information to analyse the reasons.
 - Present reasons to management.
 - iii. Verify any donations and penalties are charged to products?
- xv. **Audit of Packing Material Cost:**
 - a. Negotiations for high value items:
 - Whether Efforts kept in negotiating the rate of high value consumption packing materials.
 - For high value material items, whether the company entered into fixed price contracts for entire requirement during a period or not
 - b. **Minimization of losses:** Whether entity taken proper steps to minimize handling losses and wastages.
 - c. **Recovery:** Verify whether packing materials and packing cost is recovered separately in the sales invoice or not.
 - d. **Balancing of Inventory:**
 - Verify balancing of packing materials inventory is correct or not.
 - Opening stock purchases-consumption = closing stock
 - e. **Issue Methods:** -
 - Verify appropriate material issue method is adopted by the entity.
 - Whether material issue method adopted by the entity is followed consistently or not.
 - f. **Self-Manufactured:** If any packing materials are self-manufactured, then cross check whether it was treated as separate cost centre or not.
 - g. **Damages and Penalties:** Check whether any demurrage charges or detention charges or any penalty incurred in connection with packing materials are included in the packing material cost or not.
 - h. **Goods in Transit:** In case packing materials in transit, Please verify ownership of such goods is passed on or not.

- i. **Stock Valuation:** Verify both opening stock and closing stock valuation reports along with any adjustments carried on to identify any discrepancies.
- j. **Trend of 5 Years:**
 - Trend of Rates of packing materials over last 5 years
 - Trend of consumption of key packing materials over last 5 Years
 - Packing material cost per MT of finished product over last 5 years.
- xvi. **Audit of Sales Value:**
 - a. **ABC Analysis:**
 - Final products should be classified into A Category, B Category and Category on the basis of sales value of each product.
 - More focus should be kept on A category and B category Product items.
 - b. **Verify the efforts of the department:**
 - To increase sales realization to absorb any increase in variable cost
 - To procure more orders for product/products having higher contribution
 - c. **Resource movement:** Verify Whether company has diverted resource allocation from low contribution products to high contribution products improve overall profitability.
 - d. **Capacity Creation:** Check, Whether there is any expansion of production to capacity for product/products enjoying higher contribution
 - e. **Reconciliation of inventory:** Check that there is a proper balance between the opening stock, production, sales and closing stock in order to ensure no unnecessary locking up of working capital in terms of closing stock
 - f. **Capacity Vs Sales Value:** Check that any increase in production capacity has resulted in increase in sales quantity without affecting corresponding sales realization

Overall Checklist of Audit Programme:

A. One Time Information:

- Organization chart
- Process of manufacture with Flow Chart
- Blue print of production area with machine locations
- List of cost centres - production and utilities/services
- Machine details of individual cost centres, Capacity of each machine/cost centre
- Cost centre-wise/machine-wise deployment of workers
- Product details - different types and products manufactured/produced
- Details of any product manufactured under any technical collaboration, license agreement, Terms of payment of royalty if any

- Standard raw material composition of products/Bill of materials
- Details of process chemicals, Indirect materials
- Details of packing materials, types of packing stocking units
- Details of utilities/services-separately for each type of utility like Water, DM Water, Steam, Power, Compressed Air etc.
- Details of pollution control measures, effluent treatment etc.
- Details of products exported, export incentives, if any
- Finance Costs - types of loans (term loans, working capital loans), terms of loan arrangements.
- Budgetary control system, if any, methodology of budget preparation and variance analysis
- Cost accounting system and policy in vogue
- System of capturing of expenses and income and booking thereof

B. Data required for the Audit Period:

- Balance Sheet and Profit & Loss Account with schedules and Trial Balance
- Details of Inventories - quantity and value
- Expense analysis cost centre-wise for individual heads of expenses
- Details of all raw materials consumed including process materials/chemicals showing receipts, issues and balances.
- Raw material and process materials/chemicals consumption details both in quantity and value for individual products-material-wise
- Packing material details both in quantity and value for individual products
- Quantitative details of individual products from issue of raw material to the product till finished packed stage showing product-wise work-in-progress production and finished stock details
- Details of scrap/wastage generated at each stage of production. If the waste/scrap is recycled in the production process, quantitative adjustment thereof
- Details of utilities self-produced/generated- utility-wise
- Details of utilities consumed by user departments/cost centres in quantity including utilities purchased, if any Cost centre-wise expense analysis in respect of individual heads of expenses
- Cost centre-wise machine utilization details
 - Down time details-normal and abnormal
 - Product-wise running hours, production in quantity
- Product-wise sales analysis showing domestic and export sales separately in quantity and value
- Basis of factory/production overheads and other overheads allocation and apportionment
- Statutory returns of GST and other statutes

COST AUDIT DOCUMENTATION AND AUDIT PROCESS

Cost Audit Documentation

1. Audit documentation:

- 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.

2. Audit file: Audit file means

- One or more folders or other storage media,
- In physical or electronic form,
- Containing the records that comprise the audit documentation for a specific assignment or audit.

3. Audit working papers:

- 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,

STAGES IN AUDIT

The stages of an audit of cost statements are

1. Planning:

- a. It is well said that a well-planned audit is almost half way done. It involves
 - ✓ **determining the audit strategy** as well as
 - ✓ identifying the nature and the timing of the procedures to be performed.
- b. This is done to optimize **efficiency and effectiveness** when conducting an audit.
 - Efficiency refers to the amount of **time spent gathering audit evidence**.
 - Effectiveness refers to the **minimization of audit risk**.
- c. 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 an Audit:

- It involves **detailed testing** of internal controls, material consumptions, cost accumulation, allocation, apportionment, and absorption.
- If an auditor plans to rely on their client's system of internal controls, they will conduct **tests of controls**.
- Cost auditor will conduct detailed substantive tests of audit procedures for the period and detailed substantive tests of consumptions and balances recorded at the period end.

Cost Audit Documentation, Audit Process and Execution

- This detailed testing provides the evidence that the cost auditor requires to determine whether the cost statements have been fairly presented.

3. Concluding and Reporting

- 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.
- Cost auditor will draw his opinion on the basis of
 - 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.

Comparative Analysis of Audit Process:

Phase	Activities involved	Purpose / Object	Documentation
Planning	Perform preliminary Engagement Activities	Decide whether to Accept the engagement	<ul style="list-style-type: none"> • Listing of risk factors • Independence • Engagement letter
	Plan the Audit of Cost statement	Develop an Overall Audit Strategy and Audit plan	<ul style="list-style-type: none"> • Materiality • Audit team Discussion • Overall Audit strategy.
Performance of Audit	Perform Audit procedures	Identify/ assess risk of material misstatement through understanding the entity & its process	<ul style="list-style-type: none"> • Business Risk and Fraud risk including significant risk Update Overall strategy. • Design & Implementation of relevant internal Controls • Assessed risk of Material misstatement at Statement level • Assertion level
	Design Overall responses & further Audit procedures	Develop Appropriate responses to Assessed risk of material misstatement	<ul style="list-style-type: none"> • Update Overall Strategy • Update Overall responses audit procedures

	Implement responses to assessed risk of material misstatement	Reduce Audit risk to Acceptability low level	<ul style="list-style-type: none"> • Work performed. • Audit findings • Staff Supervision • Working papers reviews
Reporting	Prepare the cost Auditors report	Form an Opinion based on cost Audit findings.	<ul style="list-style-type: none"> • Significant Decisions • Signed Audit Opinion

PRACTICAL STEPS OF AUDIT PROCESS

Steps of cost audit process refers to what exactly a cost auditor does when he undertakes a cost audit. The following are various aspects involved.

1. **Objectives of Audit and Management Outlook:** The cost auditor should understand whether the audit is meant **only for meeting with the statutory requirements** or the management does have **anyother expectations** in its mind from the cost audit, such as
 - a. Cost optimization or cost reduction
 - b. Checking parameters of operational efficiency of a unit or any utility or any other function or department
 - c. Suggesting product diversification or changed product-mix
 - d. Identifying profit making or loss-making products
 - e. Suggesting changed marketing strategies; market expansion; market diversification
 - f. Complete review of business strategies
2. **Pre-conditions:**
 - i. The cost auditor should fully understand the following:
 - 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
 - ii. The auditor should ascertain whether the Management understands its **scope of work and responsibilities**.
 - for maintenance of cost records & producing them to the cost auditor,
 - preparation & presentation of cost statements & other details as per the applicable reporting framework, and in compliance with the cost accounting standards.
 - selection and consistent application of appropriate cost accounting policies etc.
 - iii. **Understanding the Company's Business:** The cost auditor is required to understand the

company's business, its corporate structure and various systems followed. The following are the few examples.

- Nature of activities, its size, product profile, unit locations, ownership, structure, management structure, organizational structure, marketing set-up, accounting set-up, etc.
- The nature of the industry or the sector in which client company operates.
- The applicable regulatory framework, financial reporting framework and cost reporting framework
- The company's production process, product details, joint or by-products, outsourcing, if any
- Details of subsidiaries, associates and joint ventures
- Key personnel in all departments including in Finance, Accounts, Costing, IT, Administration, Production, Purchase, Sales etc

iv. Planning the Audit: it includes:

- Timing and duration of audit period including plan to visit the unit(s)
- Level and number of audit personnel to be deployed including supervision and review of work done by the audit team
- Audit partner to be deployed and his expected days & dates
- Drawing up an overall audit plan and audit strategy - this will act as guide to the audit team
- Deciding the materiality levels & sampling levels f. Formulating appropriate audit procedures
- Formulating risk assessment strategies & procedures i.e. methodology to measure material misstatements
- Planning for discussions with key personnel of the company, previous cost auditor, statutory financial auditor, and internal auditor

v. Execution of Audit:

- a. Performing the audit checks and procedures, as planned
- b. Collecting all required audit evidence enabling the auditor to form his opinion
 - validating their relevance and reliability
 - checking their accuracy, completeness and sufficiency
 - checking the source and consistency
- c. Preparing draft observations & discussing with key management personnel
- d. Preparing final audit report

vi. Audit Documentation

- ✓ Documenting audit plan, audit strategy, working papers, audit evidences, draft observations and discussions and final report.
- ✓ Preserving all documents in a bound folder/filing for the prescribed period.

PREPARATION AND FILING OF COST AUDIT REPORT

Introduction:

A Cost Auditor is required to submit his report in Form CRA-3 which is required to be prepared on the basis of data and information available in the cost accounting records and other data maintained by the company in accordance with CRA-1 of the rules.

Qualified Audit Report:

The Cost Auditor Issues Qualified Audit Report in the following situations:

- ❖ If the **cost statements are materially misstated** due to misstatement in
 - one particular cost element,
 - class of transaction or
 - disclosure that does not have pervasive effect on the cost statements
- ❖ The cost auditor is unable to obtain audit evidence regarding
 - Particular cost element.
 - Its allocation and apportionment.
 - Class of transaction. Or
 - Disclosure that does not have pervasive effect on the cost statements

Adverse Audit Report:

The Cost Auditor Issues Adverse Audit Report in the following situations:

- ❖ **Reasons:** The cost statements are materially misstated and such mis-statements have pervasive effect on
 - The cost of production,
 - Cost of sales and
 - Margin of the products.

Impact: Stating that the information contained is materially incorrect, unreliable, and inaccurate in order to assess the company's operational results

Cost Audit Report in XBRL format:

Applicability of XBRL

- "Every company covered under Companies (Cost Records and Audit) Rules 2014 shall, within **30 days** from the date of receipt of a copy of the cost audit report.
- Furnish such report with the Central Government along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in **Extensible Business Reporting**

Language format.

1. **Management of XBRL:** It is the open international standard for digital business reporting managed

by a global not for profit consortium called "XBRL International"

- 2. Efficient Reporting:** XIIRI. makes reporting more accurate and more efficient. It allows unique tags to be associated with reported facts, allowing:
- People publishing reports to do so with confidence that the information contained in them can be consumed and analyzed accurately.
 - People consuming reports to test them against a set of business and logical rules, in order to capture and avoid mistakes at their source.
 - 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
 - People consuming the information to do so confident that the data provided to them conforms to a set of sophisticated pre-defined definitions.

Potential uses of XBRL: XBRL has applications in the following areas:

- Internal and External Reporting:** for internal and external purposes by an entity involving financial and costing data/information.
- Reporting to Regulators:** Business reporting to all types of regulators, including tax and financial authorities, central banks and governments.
- Financial Institutions:** Filing of loan reports and applications; credit risk assessments.
- Information exchange:** Exchange of information between government. Departments, institutions like banks.

Benefit from using XBRL.

- Automation:** All types of organizations can make use of XBRL to automate their process of data collection and distribution to various stakeholders.
- Cost Savings:** It helps in saving costs and improving the efficiency in managing business information-financial or cost.
- Flexibility.** XBR-being extensible and flexible, can be adapted to a wide variety of requirements.
- Benefit all stakeholders:** All stakeholders whether they are preparers, transmitters or users of business data in the financial information supply chain can benefit from the use of XBRL.

Costing Taxonomy

- ✓ Costing Taxonomy is a dictionary of all cost elements required in the cost audit 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

Conversion of cost audit report into the XBRL format:

XBRL is an open-source technology. Any of the following methods can be adopted to create the instance document required for filing of the respective reports.

- Software packages: 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.

- **Software Tools:** Various elements of Cost Audit Report can be mapped into XBRL tags of the costing taxonomy using specialized XBRL software tools specifically designed for this purpose.
- **Third Party Packages:** Different third party packages can be integrated into the existing accounting systems to generate XBRL Cost statements.
- **Web Based Applications:** There are various web based applications available that take input reports in various formats viz. Microsoft Excel etc. and transform them into XBRL format.

Process to be followed to file the reports in XBRL. Format The following steps have be followed in sequence:

- ✓ **Cost Element Mapping:** Mapping the individual cost elements of the company to the elements of the costing taxonomy.
- ✓ **Data Population:** Populating the relevant data in the software/filing tool.
- ✓ **Creation of document:** Creating instance document.
- ✓ **Data Validation:** Validating the Instance Document with the Validation Tool of MCA.
- ✓ **Conversion:** Use available tool to convert the Instance document to a human readable format and check correctness of data.
- ✓ **E-filing:** Attaching the Instance Document to the e-Form and filing on MCA Portal.

STEPS FOR FILING COST AUDIT REPORT IN XBRL FORMAT ON MCA PORTAL

- Creation of XBRL instance document
- Download XBRL validation tool.
- Load the instance document.
- Validate the instance document!
- Pre-scrutiny of the instance document
- Convert to PDF and verify the contents of the instance document.
- Attach instance document to the Form CRA-4
- Submitting the Form CRA-4 on the MCA portal.

COST AUDITOR

Who is a cost auditor? Definition:

- A cost Accountant in Practice, who is appointed by the board of directors to conduct the cost audit" as per companies (cost records & Audit) Rules, 2014.
- Cost Accountant in practice means a
 - ✓ Cost accountant as defined in sec 2(1)(b) of the cost and works accountants Act, 1959.
 - ✓ Who holds a valid certificate of practice under sec 6(1) and
 - ✓ Includes a firm or limited liability partnership of cost accountants.

Sec 142 (1) & (2) – Qualification of Auditors:

- **A person** shall be eligible for appointment as an auditor of a company only if he is a chartered accountant.
- **A firm**, where majority of the partners are practicing in India are qualified for appointment, may be appointed by its name to be the auditors of the company.
- **Where LLP** is appointed as auditors of the company, only the partners who are chartered accountants are authorized to act and sign on behalf of the firm.
- **Chartered accountant** means a chartered accountant as defined in the chartered accountants of India Act, 1949 who holds a valid certificate of practice of Practice of the Act.

Sec. 141 (3) & (4) – Dis – Qualifications of Auditors

The following person are not eligible for appointment as an **COST AUDITOR** of a company:

1. **Body Corporate:** A body corporate other than a limited liability partnership.
2. **Officer/ Employee:** An officer or employee of the company.
3. **Partner/ Employee of employee of entity:** A person who is partner or who is in the employment, of an officer or employee of the company.
4. **A person who or his relative or partner:**
 - **Holding security > Rs 1,00,000:** is holding any security of or interest exceeding face value of Rs 1,00,000: in the company or its subsidiary, holding or associate company or a subsidiary of such holding company. (a relative may hold security or interest in the company of face value not exceeding Rs 1,00,000).
 - **Indebted > Rs 5,00,000:** Is indebted to the company or its subsidiary, holding or associate company or subsidiary of such holding company, in excess of Rs 5,00,000 or
 - **Guarantee for > Rs 1,00,000:** has given a guarantee or provided any security in connection with

the ineptness of any third party to the company or its subsidiary, holding or associate company or subsidiary of such holding company more than Rs 1,00,000.

- **Business Relationship:** A person or firm who, whether directly or indirectly has a business relationship with the company or its subsidiary, holding or associate company or subsidiary of such holding company or associate company.
- **Relative of Director / KMP:** A person whose relative is a director or is the employment of the company as director or key managerial personnel.
- **Full time employment:**
 - A person who is in full time employment elsewhere, or
 - A partner of a firm holding audits of more than 20 companies .On the date of appointment or re-appointment as auditor.
- **Convicted by court:**
 - A person who has been convicted by a court, of an offence involving fraud and
 - A period of 10 years has not elapsed from the date of such conviction.
- **Engaged in prohibited services:** Any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in sec 144.
- **Other Grounds:** A person shall not be qualified for appointment if he is otherwise disqualified.
 - Ceases to be members of ICAI
 - Undischarged insolvent
 - Person of unsound mind.
- **Subsequent disqualification – Casual Vacancy:**
 - A. If any auditor, after his appointment, becomes subject to any of the above disqualification.
 - B. He shall be deemed to have automatically vacated his office and vacancy shall be considered to be a casual vacancy.

Sec. 144- AUDITOR NOT TO RENDER CERTAIN SERVICES

- i. **Approved services:** An auditor of the company can provide only those other services as approved by the board of directors or Audit committee.
- ii. **Prohibited services:** The following services shall not be provided by an auditor directly or indirectly to the company or its holding company or subsidiary company .
 - Accounting and bookkeeping services.
 - Internal audit.
 - Design and implementation of any financial information system.
 - Actual services.

- Investment advisory services.
 - Investment banking services.
 - Rendering of outsourced financial services.
 - Management services.
 - Any other kind of services as may be prescribed.
- iii. Existing Auditor before commencement of this ACT: Any existing auditor which renders and of the non-audit services, shall comply with sec 144 before the closure of the first financial year after the date of commencement of the act.

Sec 142- AUDITORS REMUNERATION

- i. **Fixation of remuneration:** The remuneration of the auditor shall be fixed by the members
 - a. In its general meeting or
 - b. In such manner as any be determined at the meeting.
- ii. **First auditors' remuneration:** the remuneration of first auditor may be fixed by the board of directors.
- iii. **Inclusions in remuneration:** remuneration includes:
 - a. Fees payable to the auditors.
 - b. Expenses, if any, incurred by the auditor in connection with the auditor and any facility extended to the auditor.
- iv. **Exclusive in remuneration:** Auditors' remuneration does not include amount paid for any other service rendered by the auditors at the request of the company.
- v. **Disclosure of remuneration:**
 - a. Auditors' remuneration should be disclosed under "Other expenses".
 - b. In the notes, expenses incurred towards auditors' remuneration should be disclosed under each of the following sub-heads:
 - For Audit services
 - For taxation matters.
 - For company law matters.
 - For other services
 - For reimbursement of expenses

Sec 148- COST AUDIT

1. Maintenance of cost accounts/ records - Sec 148 (1):

- a. The central government can order for maintenance of cost accounts/ records comprising particulars relating to.

- Utilization of material or labor or
- Other items of cost as may be prescribed.
- b. Such order may be for specified class of companies, engaged in production of specified goods or providing prescribed services.

2. Cost Audit -Sec 148(2):

- a. Cost audit is the audit of cost records.
- b. It is an audit process for verifying the cost of manufacture or production of any article on the basis of accounts as regards utilization of materials or labor or other items of costs, maintained by the company.
- c. The central government may, if it feels necessary, direct by an order that an audit of the cost records by a company shall be conducted in the prescribed manner.
- d. Such order relating to cost audit shall be given in case of companies:
 - Which are covered U/sec 148(1). i.e., maintenance of cost records/ accounts and
 - Which have a net worth turnover of prescribed amounts.

3. Cost auditor - Sec 148(3):

- a. Cost audit shall be conducted by a cost accountant in practice (either individual or firm)
- b. A statutory auditor of the company U/sec 139 cannot be a cost auditor of the company.
- c. Cost auditor shall comply with the cost auditing standards issued by the institute of cost accountants of India, with the approval of the central government.
- d. The appointment and remuneration of cost accountant is as under: D 17
 - i. **If audit committee is required U/sec 177:**
 - Cost auditor shall be appointed by board, on the recommendations of the audit committee.
 - Remuneration is recommended by the audit committee, approved by BOD and ratified by shareholders.
 - ii. **If audit committee is not required U/sec 177:**
 - Cost auditor should be appointed by BOD on its own.
 - Remuneration and ratified by the shareholder.
- e. Cost audit shall be in addition to the audit conducted U/sec 143.

4. Rights, Duties of cost auditor - sec 148(5):

- The qualifications, disqualifications, rights, duties and obligations applicable to auditors under Chapter X (Statutory auditor) are applicable to cost auditor also.
- The company is duty bound to give all assistance and facilities to the cost auditor for auditing the cost records.

5. Cost Audit Report- Sec 148(5), (6), (7):

- The cost auditor shall submit his report to the board of directors of the company.

- Within 30 days from the receipt of cost audit report, the company shall furnish full information and explanation on every reservation or qualification contained in the cost audit report, to the central government.
- If the central government calls for further information and explanations, the company should furnish the same within the timeframe specified by central government.

6. Non-Compliance -sec 148(8):

- a. The company/ officer in default is punishable in the manner provided in sec 147(1).
- b. The cost auditor is punishable in the manner provided in sec 147(2) to (4).

Sec 143: Rights/ power of auditors:

- i. Sec 143(1)- Right of access to books and vouchers:
 - a. The company auditor shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or elsewhere.
 - b. The company auditor is entitled to require from the officers of the company, such information and explanations
 - c. as the auditor may think necessary for the performance of his duties.
- ii. Sec 143(8) - Right to visit branches and access branch accounts:
 - If branch is audited by any person other than statutory auditor of the company,
 - A statutory auditor has the right to visit the branches and access accounts of branches.
- iii. Right to receive remuneration
- iv. Sec 145: Right to have qualification etc. read out at general meeting:
 - Qualifications, observations or comments on the financial transactions or matters which have any adverse effect on the functioning of the company mentioned in the auditor's report.
 - Shall be read before company in its general meeting and open for inspection by any member of the company.
- v. Sec 146 - Right to receive notices and to attend general meetings:
 - All notices and other communications relating to any general meeting of a company should be forwarded to the auditors of a company.
 - The auditors shall be entitled to attend any general meeting and to be heard at any general meeting, which concerns him as auditor.
 - Unless otherwise exempted by the company, the auditor shall attend the general meeting:
 - a. Either by himself or
 - b. Through his authorised representative, who shall also be qualified to be an auditor.
 - c. It is the duty of the auditor to attend the general meeting.

DUTIES OF AUDITORS:

Sec 143(1): INQUIRY INTO NOTIFIED AREAS:

The company auditor shall inquire into the following matters:

- i. **Loans and advances:**
 - a. Whether the loans and advances made by the company on the basis of the security have been properly secured, and.
 - b. Whether the terms of which they have been made are not prejudicial to the interest of the company or its members.
- ii. **Mere book Entries:**
 - a. If there are any transactions which are represented in the books of the company be merebook-entries.
 - b. If yes whether they are not prejudicial to the interests of company.
- iii. **Investment in shares and securities:**
 - a. If the company is not an investment company or a banking company
 - b. If any of the assets of the company consisting of shares, debentures and other securities.
 - c. Have been sold a price which less than their purchase price.
- iv. **Loans and advances Shawn as deposits:** whether loans and advances made by the company have been shown as deposits.
- v. **Personal expenses:** Whether personal expenses have been charged to the revenue account.
- vi. **Issue of shares for cash:**
 - Where it stated in books and papers of the company that shares have been allotted for cash.
 - Whether cash was actually received, and
 - If no cash has been actually received, whether the position as stated in the books and balance sheet is correct, regular, and not misleading.

Sec 143(2)- REPORTING AS TO TRUE AND FAIR: -

- i. **Reporting:**
 - a. The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which are required by or under to be laid before the company in general meeting.
 - b. **Compliance:** The report shall be made after considering, the following
 - The provisions of the act.
 - Accounting and auditing standards.
 - Matters which are required to be included in the audit report under the provisions of the act/ rules U/Sec 143(1)

- Best of his information and knowledge.

ii. **Other matters to be included in report:**

- a. Whether the company has disclosed the impact, if any relating to pending litigations on its financial position in its financial statements.
- b. Whether the company has made provisions, as required under any law or accounting standards for material foreseeable losses, if any on long term contracts including derivative contracts.

iii. **True and Fair view:** In addition to other reporting matters, the audit report shall state whether the said accounts, financial statements, given a true and fair view of:

- The state of the company affairs as at the end of the financial year.
- Profit or loss.
- Cash flow for the year.

Sec 143(3) – REPORTING REQUIREMENTS by Auditor's:

The auditor shall report on the following matters:

- i. **Information & Explanation:** whether he has obtained all the information and explanations which are necessary to best of his knowledge and belief for his audit.
- ii. **Proper books of Accounts:** Whether in his opinion the company maintained proper books of accounts as required by law and whether proper returns from branches have been received from the branches not visited by him or not.
- iii. **Branch audit report:** In case he received the branch auditors report, how he dealt with it in the preparation of his final audit report.
- iv. **Financial statements Vs Books of Accounts:** whether the company balance sheet and profit and loss account agree with the books of account and returns and these are prepared in compliance with all applicable accounting standards.
- v. **Observation with adverse impact:** If the auditors report contains any observation or comments which have any adverse effect on the functioning of the company, whether they have been printed and reported in italics or thick bold type.
- vi. **Disqualification of Auditor:** Where any director is disqualified from being appointed as a director under Sec 164(2).
- vii. **Adequate internal control system:** Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.
- viii. **Other matters as may be prescribed:**
 - a. Whether the company has disclosed the impact, if any of pending litigations on its financial position in its financial statements.
 - b. Whether the company has made provision, as required under any law or accounting standards,

for material foreseeable losses, if any on long term contracts including derivative contracts.

- c. Whether there has been any delay in transferring amounts, required to be transferred, to the investor education and protection fund by the company.

Sec 143 (12). (13). (15) - REPORTING OF FRAUDS:

1. **Fraud:** if the company auditor, in the course of performance of his duties, has reason to believe that an offence involving fraud or has been committed against the company, by officers or employees of the company.
2. **Auditor's duties:**
 - **Report to BOD:** Immediately after he comes to knowledge of the fraud, the auditor shall forward his report to the board or the audit committee seeking their reply or observations within 45 days.
 - **If received reply for BOD:**
 - Within 15 days of receipt of reply / observations as above, the auditor shall forward to the central government:
 - a. His report (on fraud),
 - b. Reply or observation of BOD/Audit committee thereon, and
 - c. His comments on above reply or observations. ii.
 - If no reply from BOD:
 - ✓ If no reply is received from BOD/ audit committee in 45 days,
 - ✓ the auditor shall forward his report only to the central government,
 - ✓ mentioning the fact of non-receipt of reply / observations.
 - **Report requirements:**
 - The secretary, ministry of corporate affairs, in a sealed cover.
 - Registered post with acknowledgement due, or by speed post, followed by an e-mail in confirmation thereof.
 - Report shall in auditor's letterhead, containing his membership number. postal address, email address and contact number. It shall be signed and sealed by auditor.
 - The report shall be in form ADT-4.
 - **Good faith:** No duty to which the company auditor may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred U/sec 143 (12), if it is done in good faith.
 - **Contravention:**
 - ✓ Auditor/cost accountant/company secretary who do not comply with Sec 143(12)
 - ✓ shall be punishable with fine of minimum 1,00,000 Maximum 25,00,000

COST ACCOUNTANT UNDER COMPANIES ACT:

- **KMP:** Under Sec 203, A Cost Accountant can become a Key Managerial Person having regards to qualification and experience.
- **Independent Director:** A Cost Accountant can be appointed as Independent Director of listed company having regards to relevant qualification and experience.
- **Member of NCLT:** Under Sec 409(3), A Cost Accountant in Practice having at least 15 Years of service is eligible to be appointed as a Technical Member of the NCLT.
- **Member of AT:** As per Section 411(3), A Cost Accountant who is having experience of more than 25 years in the prescribed areas is eligible to be appointed as Technical Member of the National Company Law Appellate Tribunal.
- **Company Liquidator:** Cost Accountants or firms having at least 10 years experience in company affairs can be appointed as Liquidator of company.
- **Expert:** The term 'expert' which includes an engineer, a valuer, a Chartered Accountant, a Company Secretary, a Cost Accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force
- **Valuer:** A Cost Accountant having relevant experience can be appointed as valuer under companies act subject to fulfilment of attached conditions.

PROFESSIONAL ETHICS:

- Each and every member of the profession in practice
- is required to follow certain professional ethics and code of conduct
- as prescribed by the Cost and Works Accountants Act, 1959 and Regulations there under.

Code of Ethics

- **Why Code of Ethics:** Cost and Management Accounting is one of the noble professions in India. As professionals, members of ICAI are bound by a code of professional ethics. This code stipulates and binds members of ICAI to the highest level of
 - a. care,
 - b. duty and
 - c. responsibility
 - d. to their employers and clients, the public and their fellow professionals
- **Objective of Accountancy Profession:** 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:
 - a. Credibility in information and information systems

- b. Professionalism identified by employers, clients and other interested parties
 - c. Quality of service carried out to the highest standards of performance; and
 - d. Confidence that there is a framework of professional ethics to govern the provision of services.
- **Fundamental Principle possessed by Cost Accountants:** In order to achieve the objectives of the accountancy profession, cost accountants have to observe the following fundamental principles:
- 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 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
 - f. 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

LET'S RECOLLECT THE PROVISIONS OF COST AUDIT

Sec 148-Cost Audit

- Central government may direct to conduct cost audit in respect of companies engaged in the production of such goods or providing such services and have a net worth or turnover as may be prescribed in rules.

- If company is regulated by special act and central government can direct to conduct cost audit only after consulting with regulatory body constituted under special act.
- Company is required to maintain cost records in Form CRA-01.
- If cost audit is ordered, it will be in addition to statutory audit conducted. iv.
- Requirement of cost audit shall not apply to company.
 - Whose revenue from operations, in foreign exchange exceeds 75% of its total revenue.
 - Which is operating in SEZ
 - Which is engaged in generation of electricity for captive consumption.
- The cost auditor shall be a cost accountant within the meaning of the Cost and works accountants Act 1959
- **Disqualifications:**
 - a. All disqualifications applicable to statutory auditor are equally applicable to cost auditor.
 - b. The statutory or internal auditor of the company shall not be appointed as cost auditor.
 - c. If cost auditor, after his appointment becomes subject to any of the above disqualifications, he shall be deemed to have vacated his office.
 - d. An employee of any of the partners of the firm of CA which is appointed as statutory auditor of the company U/sec 139 shall not be appointed as cost auditor.
- **Procedure for appointment:**
 - a. Audit committee is constituted:
 - Cost auditor is appointed by board on the recommendations of audit committee, if company is required to constitute audit committee.
 - Remuneration is also recommended by audit committee which is considered and approved by board and ratified by shareholders subsequently.
 - b. No audit committee: Cost auditor is appointed by board. Remuneration is decided by the board and ratified by shareholders subsequently.
 - c. Company shall appoint cost auditor within 180 days of commencement financial year.
 - d. Before, appointment, written consent and certificate shall be obtained from cost auditor.
 - e. **Notice of appointment:**
 - Company should file notice of appointment in CRA - 2 within 30 days.
 - Appointment is deemed to be confirmed unless contrary is heard within 30 days from the date of appointment.
 - Issue letter of appointment to the auditor
 - f. Any casual vacancy whether due to resignation, death or removal shall be filled by the BOD within 30 days of occurrence. Company shall inform the CG within 30 days of appointment in Form CRA-02.

- ix. **Removal before expiry of term:**
 - a. Cost auditor can be removed before expiry of his term after passing board resolution.
 - b. Opportunity of being heard and record reason for removal.
 - c. Cost auditor can himself resign.
- x. **Powers and duties of cost auditor:**
 - A cost auditor shall have the same powers and duties of statutory auditor
 - In addition, cost auditor is required to comply with cost standards.
- xi. **Cost audit report**
 - a. Cost auditor is required to submit his report to board in form CRA 3
 - b. After receiving cost audit report, company shall furnish full information and explanations on every reservations or qualifications to central government within 30 days of receipt of cost audit report in form CRA 4.
 - c. If central government requires any further information then it is the duty of company to furnish such information within given time
 - d. Cost auditor is required to forward his report duly signed by the board within 180 days from the end of the financial year.
- xii. **Contravention:** if any default is made in complying with the provisions of Sec 148
 - a. The company and every officer of the company, who is in default shall be punishable in the manner provided in Sec 147(1)
 - b. The cost auditor of the company who is in default shall be punishable in the manner provided in Sec 147.

Sec 143(1)-Powers of auditors

- i. **Right to Access to books:**
 - a. Every auditor of a company, shall have a right of access at all times to the books of accounts and vouchers of the company.
 - b. Whether kept at the registered office of the company or at any other place.
- ii. **Right obtain information:**
 - a. Every auditor shall be entitled to require from the officers of the company
 - b. such information and explanations as he consider necessary for the performance of his duties as a auditor
- iii. **Right to access books of subsidiaries:**
 - a. As auditor of holding company shall also have the right of access to the records of all subsidiaries and associate companies
 - b. as far as it relates to the consolidation of its financial statements with that of its

subsidiaries and associate enterprises.

iv. Matters to be inquired: Auditor may also inquire into the following matters.

- Whether loans and advances made by the company on the basis of security have been properly secured and whether terms on which they have been made are prejudicial to the interests of the company or its members.
- Whether transactions of the company which are represented merely by book entries any prejudicial to the interests of the company.
- Whether the company not being an investment company or a banking company, whether so much of assets of the company as consists of shares, debentures and other securities have been sold at a price less than at which they were purchased by the company.
- Whether loans and advances made by the company have been shown as deposits.
- Whether personal expenses have been charged to revenue account.
- Whether it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually received in respect of such allotment, and if no cash has actually been received, whether position as stated in the account books and the balance sheet is correct, regular and not misleading.

v. **The statement on reporting U/sec 227(1)(A):**

- a. These specific enquiries to be made during the course of audit
- b. It is not required to report unless has any special comments to make on any of the terms if satisfied, no further duty to report.
- c. Only enquires and not investigations.

Sec 143(2), (3) and (4) - DUTIES OF AUDITORS

- i. The auditor shall make a report to the members of the company on the following
 - a. On the accounts examined by him and
 - b. On every financial statements which are required by or under this act to be laid before the company in general meeting.
- ii. The auditor while making the report shall take into account the following:
 - a. Provisions of the act
 - b. Applicable Accounting standards and auditing standards
 - c. Matters which are required to be included in the audit report under the provisions of the Act or any rules made thereunder or under any order made U/sec 143(1),
- iii. Duties under CARO-2020
- iv. **Reporting of frauds by auditors - Sec 143(12):**
- v. Fraud of Rs. 1 Crore or more:

- a. If auditors has sufficient reason and information to believe that offences involving fraud of Rs. 1 Crore or more has been committed against the company by officers or its employees, he shall report the matter to
 - i. Board or audit committee within 2 days of his knowledge of fraud and seek their clarifications within 45 days.
 - ii. Central government with his report along with clarifications received from board or audit committee within 15 days.
 - iii. If board or audit committee fails to reply forward his report within 60 days from the date of knowledge of fraud.
- b. Report shall be sent to secretary, MCA in a sealed cover by registered post acknowledgement due or speed post followed by an email confirmation of the same.
- c. Report shall be on letter head of auditor and signed by auditor with seal. It should indicate membership number.
- d. Report shall be made in ADT - 4.

vi. Fraud of Less than Rs. 1 Crore:

- Auditor shall report the following matter to audit committee or to the board within 2 days of his knowledge of fraud.
 - i. Nature of fraud with description
 - ii. Approximate amount involved
 - iii. Parties involved
 - The above details of each of fraud reported to the audit committee or board shall be disclosed in the board report
- vii. If any auditor, do not comply the above responsibility, he shall be punishable with fine which shall
- a. not be less than Rs. 1,00,000
 - b. extend up to Rs 25,00,000

Sec 447-Punishment for fraud

Fraud includes

- any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner.
 - with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person,
 - whether or not there is any wrongful gain or wrongful loss;
- **Imprisonment and Fine:** Any person who is found to be guilty of fraud, shall be punishable with

- a. imprisonment for a term not less than 6 months extend upto 10 years and
- b. Fine not less than Amount involved in fraud which may extend upto 3 times of amount involved in fraud.

Sec 145-Signing of Audit Repot

The person appointed as an auditor of the company shall sign auditor's report or sign or certify any other document of the company.

- ✓ Qualifications, observations or comments on Cost transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditors report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

Sec 146-Attend general meeting:

All notices and any other communications relating to any general meeting, shall be forwarded to the auditor of the company.

- ✓ The auditor shall unless otherwise exempted by the company, attend any general. meeting either by himself or through his authorised representative, who shall also be qualified as auditor.
- ✓ The auditor shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

PROFESSIONAL AND OTHER MISCONDUCT

THE COST AND WORKS ACCOUNTANTS ACT, 1959

- It is an Act for the regulation of the profession of Cost Accountants.
- The regulation is exercised through the Institute. For the management of the affairs and for discharging the functions assigned to it by the Cost and Works Accountants Act.
- ICAI is having a Council of the Institute (Central Council). The Council has been empowered to institute any enquiry into cases where it is prima facie of the opinion that a member is guilty of professional or other misconduct

THE FIRST SCHEDULE

PART I-PROFESSIONAL MISCONDUCT IN RELATION TO COST ACCOUNTANTS INPRACTICE

A Cost Accountant in practice shall be deemed to be guilty of professional misconduct, if he:

- i. **Allowing his name:** Allows any person to practice in his name as a cost accountant unless
 - ✓ a such person is also a cost accountant in practice and
 - ✓ is in partnership with (or) employed by himself
- ii. **Pay remuneration for getting professional work:** Pays or agrees to pay directly or indirectly,

- a. any share, commission or brokerage in the fees or profits of his professional work
- b. to any person other than a member of the Institute or a partner or a retired
- c. O partner or the legal representative of a deceased partner.

Note: partner includes a person residing outside India with whom a cost accountant in practice has entered into partnership.

- iii. **Sharing profits of non-member of ICAI:** Accepts or agrees to accept either directly or indirectly
 - a. any part of the profits of the professional work of a person who is not a member of the Institute:
 - b. However, a member can enter into profit sharing arrangements, or to receive any share, commission (or) brokerage in the fees, with a member of ICAI.
- iv. **Partnership with Non-Members of ICAI: Enters into partnership**, in/outside India,
 - a. with any person other than a cost accountant in practice (or)
 - b. Person other person who is a member of any other professional body having such qualifications as may be prescribed, or
 - c. Person other than whose qualifications are recognized by the Central Government or the Council for the purpose of permitting such partnerships
- v. **Soliciting work from Non-Members: Securing professional work** from any person who is other than
 - a. an employee of such cost accountant or
 - b. not his partner or
 - c. by means which are not open to a cost accountant, any professional business:
- vi. **Attracting work by Advertisements: Solicits clients or professional work**, either directly (or) Indirectly.
 - a. by circular or
 - b. advertisement or
 - c. personal communication or
 - d. interview or
 - e. by any other means:

Exceptions: However, the following are permitted and does not constitute: professional misconduct

- i. Any cost accountant from applying / requesting for / Inviting/ securing professional work from another cost accountant in practice;
 - ii. A member from responding to tenders / enquiries issued by various users of professional services or organizations from time to time and securing professional work as a consequence.
- vii. **Publicity Modes:**
- a. Advertises his professional attainments or services, (or)
 - b. uses any designation (or) expressions other than cost accountant on professional documents, visiting cards, letter heads (or) sign boards,

c. unless

- i. it is a degree of a University established by law in India (or)
- ii. Degree recognized by the Central Government (or)
- iii. a title indicating membership of the of any other institution that has been recognized by the Central Government (or) iv. may be recognized by the Council:

Note: Member in practice may advertise through

- ✓ a write up,
- ✓ setting out the services provided by him or his firm and
- ✓ particulars of his firm subject to such guidelines as may be issued by the Council;

PART II - PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE IN SERVICE

A member of the institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm (or) person:

- ✓ **Sharing of his remuneration in any form:**
 - Pays (or) allows (or) agrees to pay,
 - directly (or) indirectly,
 - to any person
 - any share in the emoluments of the employment undertaken by him;
- ✓ **Sharing of others remuneration in any form:**
 - Accepts (or) agrees to accept.
 - any part of fees, profit (or) gains from a lawyer, a cost accountant (or) broker engaged by such company, firm (or) person (or) agent (or) customer of such company, firm (or) person
 - by way of commission (or) gratification

PART III-PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A Member of the institute, whether in practice (or) not, shall be deemed to be guilty of professional misconduct, if he:

- i. **Mis-represents as FCMA:** Not being a fellow of the institute acts as a fellow of the institute
- ii. **Non-Compliance with guidelines issued by ICAI:**
 - Does not supply the information called for, (or)
 - does not comply with the requirements asked for by the institute, Council (or) any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review

Board (or) the Appellate Authority

iii. Submits false information:

- While inviting professional work from another cost accountant (or) while responding to tenders(or) enquiries (or) while advertising through a write up
- Provides information knowing it to be false.

PART IV-OTHER MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the institute, whether in practice (or) not, shall be deemed to be guilty of other misconduct If:

- Subject to imprisonment by court:
 - a. He is held guilty by any civil (or) criminal court
 - b. for an offence which is punishable with
 - c. imprisonment for a term not exceeding 6 months
- Hamper to the reputation of Institute:
 - a. In the opinion of the council
 - b. he brings disrepute to the profession (or) the institute
 - c. as a result of his action whether (or) not related to his professional work.

THE SECOND SCHEDULE

PART 1-PROFESSIONAL MISCONDUCT IN RELATION TO COST ACCOUNTANTS IN PRACTICE

A cost accountant in practice shall be deemed to be guilty of professional misconduct, if he:

i. Breach of confidentiality:

- A cost accountant in practice should maintain highest degree of confidentiality regarding the information he gained during the course of cost audit of his clients.
- Such confidential information can be disclosed only in the following permitted situations.
 - To his client who engages him
 - To any person with the consent of his client
 - Disclosure required as per the provisions of any applicable law for the time being in force.
- Except the above cases, if cost accountant in practice disclose such confidential to any person he will be deemed to guilty of professional misconduct.

ii. Certification without examination of the same:

- a. If a practicing cost accountant Certifies any cost accounting related statements without examination of such statements by himself, or partner or employee or another cost

accountant in practice.

- b. Then such practicing cost accountant shall be deemed to guilty of professional misconduct.

iii. Certification with respect of accuracy of future estimates or cost:

- a. If any cost accountant in practice
- b. Permits his name (or) the name of his firm
- c. to be used in connection with an estimate of cost (or) earnings contingent upon future transactions
- d. in a manner which may lead to the belief that he vouches for the accuracy of the forecast

iv. Expression of opinion on entities with substantial interest:

- a. If any cost accountant in practice expresses his opinion on cost (or) pricing statements
- b. of any business (or) enterprise in which he or his firm or a partner in his firm has a substantial interest
- c. he shall be deemed to be guilty of professional misconduct.

v. Failure to disclose material facts:

- a. If any Cost accountant in practice,
- b. fails to disclose a material fact known to him in a cost (or) pricing statement.
- c. which is not disclosed in a cost (or) pricing statement
- d. but disclosure of which is necessary
- e. in making such statement where he is concerned with such statement in a professional capacity

vi. Failure to disclose Material mis-statement:

- a. If any cost accountant in practice,
- b. Fails to report a **material mis-statement**
- c. **known to him to appear** in a cost (or) pricing statement
- d. with which he is concerned in a **professional capacity**

vii. Negligence

- a. If any cost accountant in practice
- b. does not exercise due diligence or is grossly negligent
- c. in the conduct of his professional duties

viii. Falls to obtain sufficient information or explanations:

- a. If any cost accountant in practice
- b. Who fall to obtain sufficient information which is necessary for expression of an opinion or
- c. Its exceptions are sufficiently material to negate the expression of an opinion

ix. Inability to trace material departures:

- a. If any cost accountant in practice fails to invite attention to any material departure from the generally accepted procedure of costing and pricing applicable to the circumstances;
- b. He shall be deemed to be guilty of professional misconduct.

x. Non-maintenance of separate account for client money:

- a. Fails to keep money's of his client
- b. other than fees (or) remuneration (or) money meant to be expended separate banking account(or) in a
- c. to use such money's for purposes for which they are intended within a reasonable time.

PART II - PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the institute, whether in practice (or) not shall be deemed to guilty of professional misconduct the council.

- i. **Violation of Provisions:** Contravenes any of the provisions of this Act (or) the regulations made there - under (or) any guidelines issued by the council;

ii. Breach of confidentiality:

- a. Being on employee of any company, firm (or) person,
- b. discloses confidential information acquired in the course of his employment, except as and when required by any law for the time being in force (or) except as permitted by the employer,

iii. Submission false information:

- a. Any information, statement, return (or) form to be submitted to the institute Council (or) any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board (or) the Appellate Authority
- b. any particulars knowing them to be false;

- iv. **Embezzlement of Money:** Defalcates (or) embezzles money's received in his professional capacity.

PART III OTHER MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

Subject to imprisonment:

- A member of the institute, whether in practice (or) not,
- shall be deemed to be guilty of other misconduct.
- if he is held guilty by any civil (or) criminal court for an offence

- which is punishable with imprisonment for a term exceeding 6 months.

Penalties under CWA Act 1959

i. Situations for levy of penalty:

- a. Any person who is not being a member of the institute,
- b. Represents himself as a member of the institute or
- c. Uses the designation cost accountant or
- d. A member of institute without having certificate of practice represents himself that he is inpractice (or) practices as a cost accountant.

ii. Penalty:

- a. On first conviction - punishable with fine up to Rs. 1000
- b. Subsequent conviction with
 - Imprisonment which may extend to 6 months, (or)
 - With fine which may extend to Rs. 5,000 (or)
 - with both.

Section 25 - Penalty for using name of the Council, awarding degrees of cost accountancy etc

i. No person shall,

- **Use a name (or) a common seal** which is identical with the name (or) the common seal of the Institute (or) so nearly resembles it as to deceive (or) as is likely to deceive the public;
- **Award any degree**, diploma or certificate (or) bestow any designation which indicates (or) purports to indicate the position (or) attainment of any qualification (or) competence in cost accountancy similar to that of a member of the Institute; or
- **Seek to regulate** in any manner whatsoever the profession of cost accountants.

ii. Penalty:

- a. Any person contravening the above provisions shall, without prejudice to any other proceedings which may be taken against him, be punishable on
 - i. **first conviction** - with fine which may extend to Rs. 1,000
 - ii. **Subsequent conviction** -
 - with imprisonment which may extend to 6 months, or
 - with fine which may extend to Rs. 5,000, or
 - With both.

iii. CG power to impose restrictions on others:

- a. If the Central Government is satisfied that any diploma (or) certificate (or) any designation granted (or) conferred by any person other than the Institute,
- b. which purports to be a qualification in cost accountancy but

- c. which in the opinion of the Central Government, falls short of the
 - standard of qualifications prescribed for cost accountants and
 - does not in fact indicate (or) purport to indicate the position (or) attainment of any qualification (or) competence in cost accountancy similar to that of a member of the Institute,
- d. it may, by notification in the Official Gazette and
 - i. subject to such conditions as it may think fit to impose,
 - ii. declare that this Section shall not apply to such diploma (or) certificate (or) designation.

Sec 26 Companies not to engage in cost accountancy:

- i. Rule:
 - a. No Company,
 - b. whether incorporated in India (or) elsewhere,
 - c. shall practice as cost accountants.
- ii. **Penalty:** Any contravention of the provisions shall be punishable on
 - a. first conviction with fine, which may extend to Rs. 1,000 and
 - b. on any subsequent conviction to Rs. 5,000.
- iii. Company also include any LLP having company as its partner for the purpose of this section.

Sec 27-Unqualified persons not to sign documents:

- i. Rule
 - ✓ No person other than a member of the Institute
 - ✓ shall sign any document on behalf of a cost accountant in practice (or)
 - ✓ a firm of such cost accountants in his (or) its professional capacity.
- ii. **Penalty:**
 - a. Any person who contravenes the above provisions shall, without prejudice to any other proceedings which may be taken against him, be punishable on
 - **first conviction** with a fine not less than Rs. 5,000 but which may extend to Rs. 1,00,000 and
 - **Subsequent conviction** with
 - a. imprisonment for a term which may extend to 1 year (or)
 - b. with a fine not less than Rs. 10,000 but which may extend to Rs. 2,00,000 (or)
 - c. with Both.

Sec 28-Offences by Companies

- i. Rule

- the person committing an offence under this Act is a company,
 - Then the **company as well as every person in charge** of, and responsible to, the company for the conduct of its business
 - at the time of the commission of the offence shall be deemed to be guilty of the offence and
 - Shall be liable to be proceeded against and punished accordingly. e. However, any person proves that the offence was committed without his
 - knowledge, then he is not liable to any punishment.
- ii. If an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or is attributable to any neglect on the part of, any director, manager, secretary (or) other officer of the company, such director, manager, secretary (or) other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Sec 29-Sanction to prosecute

- No person shall be prosecuted under this act
- except on a complaint made by (or)
- under the order of the council (or) of the Central Government

BASICS OF MANAGEMENT AUDIT

Introduction:

- **Meaning:** Management Audit is
 - a. The total examination of transaction of an organisation, or parts of it and
 - b. 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.
- **Aspects Covered:** Management audit deals with -
 - The objectives of an organisation.
 - The policies and procedures in terms of the objective of the organisation and
 - Adequate performance of an organisation in terms of objectives, policies, and procedures.

Definition of Management Audit:

1. **Definition:** As per CIMA,
 - a. Management audit is an objective and independent appraisal of the effectiveness of the managers and effectiveness of the corporate structure in the achievement of company objectives and policies.
 - b. Its aim is to identify existing and potential management weaknesses within an organisation and to recommend ways to rectify these weaknesses".
2. **Purposes:** Management audit is carried out to:
 - Appraise the management performance at all the levels.
 - Spotlight the decision or activities that are not in conformity with organizational objectives.
 - Ascertain that objectives are properly understood at all levels.
 - Ascertain that controls provided at different levels are adequate and effective in accomplishing management objectives or plans of operations.
 - Evaluate plans which are projected to meet objectives.
 - Review the company's organizational structure, Le, assignment of duties and responsibilities and delegation of authority.

Objectives of Management Audit:

The following are the various objectives behind carrying out management audit of an entity.

- i. **Optimum Use:** To ensure optimum utilization on all the resource employed including money, materials, machines, men and methods.
- ii. **Efficiency:** to highlight efficiency in objectives, policies, procedures and planning.

- iii. **Improvements:** To suggest improvement in methods of operations.
- iv. **Identification of Weakness:** To highlight weak links in organizational structure and in internal control systems and suggest necessary improvements.
- v. **Prevention of sickness:** To help management by providing health indicators and help prevent sickness or help cure in case of sickness; and
- vi. **Proactive measures:** To anticipate problems and suggest remedies to solve them in time.

Benefits of Management Audit:

Management audit is now becoming more popular everywhere. Almost all progressive organizations undertake voluntary management audit due to its benefits as under:

- **Facilitate Management:** It helps management in framing basic policies for the organisation and to define objectives.
- **Facilitate Planning:** It helps in preparing a viable and achievable plan for the organisation
- **Framework:** It helps in setting up an organizational framework to implement the plans.
- **Designing systems and procedures:**
 - It assists in designing systems and procedures for smooth operation of the organisation.
 - It helps in designing and reviewing management information system (MIS) for decision making to help in coordination, motivation and control of the operations.

SWOT Analysis: It assists in analyzing SWOT (strengths, weaknesses, opportunities and threats) of the organisation and assists in marketing the organisation stronger.

Social Cost benefit Analysis: It can help in analyzing social-cost benefit analyses for public projects like dams, power houses, national highways etc.

Facilitate Mergers and Acquisitions: It is essential whenever a unit is planned to be taken-over or an amalgamation or merger with other unit is proposed.

Factors leads to Compulsory Management Audit:

- 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.

Scope/Issues addressed by Management Audit:

Management Audit encompasses all areas where management decision making and actions are involved. The following are the areas

- Appropriateness of Organization Structure and reporting
- Coordination among Departments to accomplish management objective
- Suggesting a 'risk management' structure for better governance
- Stakeholder management
- Project evaluation including growth budget and appropriation methodology

Management Audit Programme (MAP):

- A 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:
 - a. Review of the organizational objectives and plans
 - b. Study of the policies and practices of the management
 - c. A critical review of the organizational structure
 - d. Study of the systems and procedures
 - e. Evaluation of operations
 - f. Study of the efficiency of the use of physical resources available
 - g. Exercise of proper management control
 - h. Maintain suitable monitoring system through management information system (MIS)
 - i. Check on adherence to the statutory obligation and
 - j. Above all, review the efficiency of manpower handling, which ultimately results in the organization's success.

Management Audit Report

- i. **Audit Report:** The management Auditor shall release Management Audit Report upon completion of audit procedure.
- ii. **Assessment of Decisions:** The report submitted by a management auditor should provide proper assessment of the management decisions and on ground implementation along with implications, therefore.
- iii. **Aspects to be Covered in Audit Report:** The management auditor should cover the following areas in his report:
 - The areas of weakness and suggest for improvement.
 - Review the Stakeholder relationship and benefits passed on to them for maintaining a cordial and desired relationship.
 - The methods and procedures of production
- iv. **A Good Management Audit Report:**
 - It is important to prepare a good MAR. A good MAR can motivate the management and get the required results.
 - The detailed characteristics of a good management audit report can be summarized as follows:
 - i. Pertinence
 - ii. Comprehensiveness

- iii. Brevity
- iv. Timeliness
- v. Motivating
- vi. Formatting

Functions of Management Audit:

Management audit is a difficult and complex task. Management Audit generally performs the following functions:

1. **Identified Roles:** Management audit requires a **tight rope walking** with clear, identified roles to perform while dealing with top management.
2. **Examination of Scope of work:**
 - a. It examines all the scope of work with respect to areas for review.
 - b. In this regard, the auditor should help management in pinning down and inter-relating the performance standards and measurements with the ownership of responsibilities.
3. **Suggestions to Management:** Management audit provides valuable suggestions to the management after proper evaluation.

Financial Aspect – Management Audit:

Management Audit can address the following financial questions.

- The management's role in the annual budgeting exercise of the company.
- Plan / Budget deviations and reason therefor.
- Existence of function-based approval prior to Finance accord
- The compliance level of the current policies employed by the finance team of the company

Qualities of Management Auditor:

The management auditor should have the following qualities:

- **Knowledge and Experience:** A management auditor should have good knowledge and experience of
 - All Managerial Functions.
 - Financial, cost statements analysis techniques.
 - Economics and business laws, etc.
- **Organisation Structure and Decision:** A Management Auditor should be able to Understand the following aspects of organisation:
 - Organisation structure
 - Decisions taken by management.
 - Working of the organisation and its problems
- **Processes and Control:** A Management Auditor must have thorough understanding of all processes and control aspects.

- **Organisation Objectives:** Management Auditor should know and understand the objectives of the organisation very well.
- **Budgets:** Auditor should understand planning, budgets, rules, and procedures to be applied in management reviews.
- **Production Process:** Auditor should be well-versed with the entire production process.
- **Reasons for lack of coordination:** Auditor should have enough knowledge and experience to understand the reason behind the lack of coordination between different departments.
- **Suggestions to Management:** Auditor should have the quality of giving practical and achievable solutions to the problems in the organisation.
- **Personal Qualities:** Auditor shall have tactfulness, perseverance, pleasing and dynamic personality.

Role of CMAs in Management Audit:

- **Who Can perform:** A Cost Accountant can perform Management Audit of an Entity.
- **Specific Qualities:** A Management Auditor should have the following specific qualities.
 - **Business Problems:** Ability to understand and gauge business problem.
 - **Knowledge of Organisation:** General understanding of the organisation and its various processes at pre and post approval stage
 - **Applicable Laws:** Thorough understanding of the applicable Rules, Regulations and legal aspects.
 - **Other relevant Laws:** General understanding of different Laws - General Laws, Company Law, Tax Laws FEMA, etc. that affect the functioning of the whole of the organisation.
 - **Subject Matter Expert:** Background knowledge and subject matter expertise
 - **Personal Qualities:** Focused, dynamic and result orientation. Tactfulness, perseverance, and lastly, pleasing, and dynamic personality

Illustration 1.

A Company introduced a new product EZY with advanced technology in a product market where there is huge competition with many competitors having an individual market share of 5% to 10%. A survey of the present market estimates that demand will increase by 80,000 units per year. The company is presently targeting 50% of the additional market demand as competitors will need at least two years to match its product.

The Product EZY passes through three departments. Direct cost per unit of product at a present rate: Material cost ₹ 65 and Labour Cost ₹ 45. Overheads are absorbed based on normal capacity. The following relevant information is given:

Production Dept	Unit of Measurement	Normal monthly capacity	Monthly Allocated Fixed Overheads (₹)	Full Overhead cost Rate (₹)	Hours consumed by the product
X	Machine Hour	12,500 machine hrs	₹ 50,000	10.50	2
Y	Direct Labour Hour	15,000 labour hrs	₹ 60,000	9.00	1.5
Z	Direct Labour Hour	25,000 labour hrs	₹ 75,000	6.00	3

The company has set a target of Selling and Distribution costs of ₹3,00,000 irrespective of sales volume. The company normally sets a price by adding a mark-up on costs between 30% to 40%.

You are required to suggest the price to take care of competition from the right perspective.

Illustration 2.

ABC Co. has two Department producing small electrical goods. New Technology for the production of X will induce the following cost:

Costs	Department-A	Department-B
Direct Material	₹ 240	₹ 200
Direct Labour Rate / Hours	₹ 120	₹ 100
Direct Labour Hours	2 Hours	3 Hours
Variable OH Per Hour	₹ 50	₹ 30
Fixed Per Hour (Based on 100% Capacity)	₹ 60	₹ 40
Value of Machine on revaluation	₹ 40 Lakhs	₹ 28 Lakhs

New Technology cost = ₹ 25 lakhs, working capital = ₹ 7 lakh

The target volume of production in the 1st year is 2000 units @ 25% capacity
Variable Selling and Distribution Cost is ₹ 3 lakh for 2000 units. Expected return on investment 24%. Suggest pricing of a new product for a new one or the existing ones at 80% capacity.

Illustration 3.

A company is operating at 60% capacity with a turnover of ₹ 86.40 lakhs.

- If the Company works at 100% capacity, the sales-cost relation is: Factory Cost is two-thirds of sales value and Prime Cost is 75% of Factory Cost.
- Administrative and selling expenses (75% variable) are 20 % of sales value.
- Factory overhead will vary according to operating capacity as given below:

Operating Capacity	60%	80%	100%	120%
Factory Overhead (₹ Lakhs)	19.80	21.60	24.00	30.00

The company has planned to operate at 80% capacity. Moreover, it has received an export order and the execution of the same will involve 40 % of capacity. The prime cost of the order

is estimated as ₹ 12.00 lakhs and the shipping expenses involved will be ₹ 2.00 lakhs. Taking the same percentage of profit on the domestic sale, determine the minimum price to be quoted for the export order.

Illustration 4.

ABC Co. has planned for an investment of ₹ 800.00 lakh with a 50% Loan from Banks at 10% interest.

Direct Cost for the year ₹480.0 lakhs and 50% of which is Material cost. Other expenses are at ₹ 80.0 lakh. The goods will be sold at 150% of the direct cost. The tax rate is assumed at 50%.

Determine:

- (i) Net profit margin
- (ii) Return on Assets
- (iii) Assets turnover
- (iv) Return on owners' equity
- (v) Inventory Turnover

Illustration 5.

ABC Ltd which is manufacturing consumer products has two divisions Assembling and Finishing. The two divisions are operating as cost centers

- (i) Present activities and costs involved in the Assembling division & Finishing division and a year:

Assembly Division:

No of sets assembled: 12,000

Manufacturing of parts (including material): ₹ 6.00 lakhs

Parts purchased from the market: ₹ 4.00 lakhs

Another Variable cost: Welding cost- ₹ 5 lakhs and Assembling cost- ₹ 9.00 lakhs
Fixed cost for the unit: ₹ 6 lakhs

25% of the production of the Assembly division is sold in the market for ₹ 300 per set and 75% is transferred to Finishing Division at ₹ 280

The cost incurred in Finishing Division:

Painting cost: ₹ 5.00 lakhs; Polishing cost: ₹ 1.00 lakhs; Fixed cost ₹ 4.00 lakhs. The selling Price per set is ₹ 450.

Evaluate the following situations:

- (ii) Division Assembly has proposed for expansion of their division for an enhancement of capacity by 20% for ₹20 lakhs. It is indicated that there will be no change in factory fixed cost in the operation of additional volume of job. Division Assembly proposes to maintain the transfer to the finishing division to the existing level and sell additional sets to market at the present price.
- (iii) Division Finishing has proposed for a transfer of the whole of the output of the Assembly division for ₹280 per unit and the additional units can be sold in the market at the existing price which will involve advertisement expenses to the extent of ₹ 4.00 lakhs and fixed cost in the division will go up by ₹ 1.00 lakhs.
- (iv) Assembly division claims that the transfer rate of ₹ 280 is irrational in a sense of undue favour to the Finishing division at their cost and the Finishing Division is given the advantage of the market price for their products whereas the Assembly division is deprived of that advantage. The Assembly division agreed to transfer the whole of its output to Finishing Division for ₹ 300.

You are required to give your recommendation assuming the opportunity cost of capital is 15%.

MANAGEMENT REPORTING ISSUES AND ANALYSIS

Introduction:

Report: Report refers to a statement containing facts

- **Reporting:** Reporting can be defined as the communication of statements with related information between the two parties.
- **Management Reporting:** The process of providing information to the management is known as management reporting.
- **Quality of a Report:** The quality of the Report brings clarity on the Objective for which the service was sought for, efficiency and ability of the Team deployed for review, depth of skill and handling specifics.

Management Reports:

Management Reports are purposive and depend upon management requirement.

➤ Types of Reports based on Content:

- a. **Financial Reports** - This report contains financial information like budgets
- b. **Information Reports** - This report carries information based on analysis. It may be
 - ✓ Trend reports
 - ✓ Analytical reports
 - ✓ Activity reports
- c. **Control Reports** - These contain evaluation of performance of each responsibility center within the entity.

➤ Types of Reports based on Nature:

- **Enterprise Reports**- These provide detailed description of the various - operating activities and financial position of the business.
- **Investigative Reports** - These will be prepared only when to investigate a particular problem.

➤ Types of Reports based on Function:

- **Individual Activity Report** - It is prepared for the individual activity of single department working under the supervision of one executive.
- **Joint Activity Report** - It is prepared when joint efforts are made in performing the activity.

Performance Analysis:

1. The basic objective of preparing a Report on Performance Analysis is to provide an actionable insight into costs and profitability for the management in the strategic and operational context.
2. It aims to discover various drivers of costs and profitability and their impact on the selected performance variables. It would help the organizations:
 - a. To improve profits and profitability
 - b. To optimize resource allocation

c. To optimize the product and services portfolio

3. The following **criteria** may help the management auditor to select and include the various performance measurement criteria in the Report on Performance
 - Effect on profitability
 - Effect on resource utilization.
 - Effect on liquidity
 - Effect on risks
 - Effect on quality
 - Effect on competitiveness
 - Effect on responsiveness to the market etc.

4. An ideal Report on performance Analysis should possess the following.

Characteristics:

- ✓ Objectivity
- ✓ Capability of being predictive value
- ✓ Comprehensiveness
- ✓ No information overload.
- ✓ Coverage of strategic thrust
- ✓ Trend measures and current status
- ✓ Timeliness
- ✓ Segmented and enterprise-wide coverage.

Mechanism for performance Analysis:

- After analyzing the activities within each process, we give below the **mechanism for performance** analysis as follows:
- Performance measures provide a snapshot of current performance capabilities and track whether actual performance is getting better, staying the same, or getting worse over time. Machine hour rate is a performance measure which provides us input for various decisions.
- Capital expenditures tell about the investment of funds; we communicate the return on that investment through performance measures.
- Keep the focus of the chosen performance measure on things that matter most, such as:
 - ✓ Are we accomplishing our mission to analyze performance?
 - ✓ Are the processes achieving strategic goals and objectives?
 - ✓ Are the customers satisfied? d. Are various processes being managed by the company properly?
 - ✓ Are the output and outcomes observed result in the company being cost-efficient as the industry leader?
 - ✓ The auditor could summarize the plan in order to have clarity.

Steps suggested for report on performance Analysis:

Suggested below are the steps involved in the preparation of the performance analysis:

Step 1. Identify and understand the key strategies of the company, both prescriptive and emergent strategies included.

Step 2. Choose strategies that have more visible expressions in costs data maintained by the

company.

- Step 3.** Identify the activities that were impacted by the strategies selected and also implemented during the year.
- Step 4.** Analyze the cost implications of those activities and link it with the expected results of the strategies.
- Step 5.** Present the evaluation, in a table or any other easily comprehensible format like histogram, chart, graph etc.
- Step 6.** Give explanatory notes for the terms used, calculations made, and assumption behind the evaluations.
- Step 7.** Finalize the finding after a discussion with the concerned operating executives and then with the management of the company.

Contents of the Report on performance Analysis:

The Report on Performance Analysis may cover the following areas:

- ✓ Capacity Utilization Analysis
- ✓ Productivity/Efficiency Analysis
- ✓ Utilities/Energy Efficiency Analysis
- ✓ Key-Costs & Contribution Analysis
- ✓ Product/Service Profitability Analysis
- ✓ Market/Customer Profitability Analysis
- ✓ Working Capital & Inventory Management Analysis
- ✓ Manpower Analysis
- ✓ Impact of IFRS on the Cost Structure, Cash-Flows and Profitability
- ✓ Application of Management Accounting Tools

Capacity utilization Analysis:

- The basic quantitative information on capacity is covered in Annexure 1 of Part B and C of CRA 3- Quantitative Information.
- The auditor should collect information of theoretical capacity, practical capacity, normal capacity and budgeted capacity for the period under review. Although the information may be available for all machinery & equipment, the auditor should identify the "constraint" that would limit the capacity of the entire organisation or product or a certain geographical area.
- The auditor should assess various capacity limits for better analysis and reporting. All these have costs and could affect profitability. These are:
 - a. Internal physical capacity-machinery & equipment
 - b. External physical capacity-subcontracting and leasing
 - c. The capacity of manpower bandwidth at all levels
 - d. The financial capacity
- The capacity performance measures could be:
 - a. Computation of Capacity ratios to measure utilization.
 - b. Identification of bottlenecks & their impact on costs

- c. Ability to serve markets by creating short term capacity.
 - d. Analysis of throughput per hour of constraint capacity resource and return per hour at this resource (could be done decomposing the Throughput Accounting ratios)
 - e. Committed capacity costs by process and managed capacity costs by process.
 - f. Impact of wastages on capacity utilization
- The auditor's **checklist** would include processing of information gathered from sources viz:
 - a. Technical documents pertaining to the equipment.
 - b. Production planning reports
 - c. Interviews with managers responsible
 - d. Wastage and down-time reports
 - e. Benchmarking exercises done, if any
 - f. External sources providing suggestive capacity reporting formats like CAM-1 publications (Consortium for Advanced Manufacturing - International)

Productivity and Efficiency Analysis:

1. Productivity involves variables of input resources and output. It should be noted carefully that productivity is a measure of efficiency per unit of output, whereas efficiency is generally measured in totality.
2. CRA-3 to the cost audit report provide some basic information about the input costs and their relationship with the output. The auditor should further analyse these areas to identify causes of good performance and areas that need improvements.
3. The considerations in measuring productivity and efficiency performance could be:
 - a. Performance of input factors such as material, people, tools, equipment, processes, management, capital funds etc.
 - b. The output factors could be units produced and sold, number of customers served, reduced costs, improved responsiveness etc.
4. The performance measures in respect of this area could be:
 - a. Inputs utilized (material, man, machine, capital etc) per unit of output or output obtained per unit of an input variable.
 - b. Wastages as percentage of input
 - c. Development of indices for Single Factor Productivity (SFP), Multi-Factor Productivity (MFP), Total Factor Productivity (TFT)
 - d. Inter-relationships in various productivity measures e.g. output per man-hour, higher wastage per man hour, etc.
5. The cost auditor's **checklist** would include, inter alia, the following:
 - The Bill of Material (BOM) for each product\
 - The standard cost card, if any
 - Internal reports on consumption, wastages per unit of input to capture actual data
 - Production scheduling and plans to measure labor & machine time productivity.
 - External benchmarking such as industry norms, best practices data etc. used by the company or generated by auditor for analysis.

Utilities and Energy Efficiency analysis:

- The utilities are resources that are used in the process of conversion of material and other components into a finished product, but these resources do not form part of the physical unit of the product.
- The performance appraisal parameters for energy and utilities would include the consumption of fuel for generating energy and then the use of the energy thus produced per unit of final product. The performance parameters could include the following:
- Energy generated per unit of fuel consumed or fuel consumed per unit of energy generated. This could be applied for power, steam, electricity, water etc.
- Measurement of improvement in power factor (denoting reduction in the KVA demand charges)
- The cost of generating energy per unit and the cost of consuming the energy per unit of the finished product would be the critical part of the analysis.
- Trend analysis of energy costs as percentage of total production costs is a good indicator of performance.

Key Costs and Contribution analysis:

- The auditor should check the reasonableness of the contribution by benchmarking the industry average wherever applicable.
- The contribution analysis should also be extended to include the break-even analysis and the margin of safety at the current volumes. It may be necessary for the auditor to scientifically split the costs into fixed and variable elements. This split should be validated every year to find structural changes if any. It will help to include inter-firm comparison for the same.
- The auditor should report on evaluation of use of the contribution analysis data by the management for decisions like pricing, accepting or rejecting an order, make or buy etc.
- The checklist for the auditor could include:
 - a. Sales and production records
 - b. Reconciliation with GST records
 - c. Price lists and discount structure policy
 - d. Product cost statements
 - e. Operational budgets

Product / Service Profitability Analysis:

- The unit product or service profits are driven by two major components viz. cost per unit and selling price per unit. The auditor should analyse if the business belongs to the sellers' market or buyers' market.
- The auditor is expected to provide a thorough evaluation to bring out the products and/or services that are contributing more or less to the overall company performance. For convenience purposes, the products and/or services could be classified in groups with similar risk-return profiles.
- The **checklist** for the auditor could include:

- Sales and production records
- Reconciliation with GST records
- Price lists and discount structure policy
- Product cost statements
- Operational budgets

Market / Customer profitability:

- Certain industries focus on limited markets and customer types, while the others are broad based. The management may choose to understand its position in the different markets and different customers it serves.
- The markets could be segmented on the basis of geographical locations such as domestic & international, zones or regions. They can also be segmented based on customers, e.g. OEMs, institutional, dealers, aftermarket, retail etc. These are normally termed as channels of distribution. Sales and supplies to Government, related parties could also be used for analysis. The challenge in all the above-named method of segmentation lies in the computation of costs for each of them. The auditor should carefully evaluate the allocation of costs to the different channels, especially marketing & campaigning costs.
- The checklist for evaluation of performance in this area could be based on the study of
 - Market and customer-wise sales and cost reports.
 - The marketing campaigns undertaken by the company.
 - Date on new markets or new customers added during the year.

Working capital and Inventory management analysis:

- This part of the report should point out the efficiencies in operations through management of different components of working capital. The auditor should identify all the elements of working capital for each product group and evaluate the adequacy or otherwise thereof.
- For manufacturing industries, inventory is the major portion of the current assets. The auditor should evaluate the inventory management policy which would include, inter alia, procurement policy, stocking policy, inventory valuation method, inventory records and physical verification procedures.
Benchmarking of the policy pursued by the company with the industry averages will enhance the value of performance report.
- Observations about other components of working capital and trends therein could be noteworthy. These components may be loans and advances, other receivables and payables etc. the criteria for analysis here should be to find whether excessive amount is blocked in these areas. Cash management can be included in the analysis. iv. It will be helpful to include the observations on cost of working capital funding. These costs may include:
 - the interest paid on cash credit and loans,
 - cost of using factoring services,
 - cost of collection efforts,
 - costs involved in cash management,
 - cost of inventory carrying etc.
- These costs may be explicit or implicit. Reasonable assumptions could be made for computing

the implicit costs. The total cost of managing working capital as a percentage of total working capital invested may be a very useful performance indicator.

- The auditor's checklist could include the reference to the following:
 - Records related to inventory of RM, WIP and FG, stock discrepancy reports
 - Inventory aging reports, reports on treatment of non-moving items
 - Reports on receivable-aging, timely collection, bad debt etc.
 - Terms and conditions of working capital funds such as bank credit, loans etc.

Manpower Analysis:

- ✓ The depth of analysis of manpower could depend upon the proportion of manpower cost to the total cost of product or service. The performance criteria for this area will mainly be related to the costs and efficiency or productivity.
- ✓ The costs may be categorized into the cost of recruitment, **cost of maintaining the manpower and the cost of separations**,
- ✓ **Recruitments costs** may include position advertisements, commission paid to recruitment agencies, participation in job fairs or campus recruitment etc.
- ✓ **The maintenance costs** may be the training & development costs, facilities provided over & above the monetary benefits etc.
- ✓ **The separation costs** would mostly be implicit costs. These costs as a percentage of the total salaries and wages would provide an insight into the quality of manpower management.
- ✓ The auditor's checklist for this content area may be
 - Details of number of recruitments done, number of people left, the labor turnover ratios.
 - The data on idle time, absenteeism
 - Manpower productivity reports
 - Use of temporary or casual labor
 - Turnover at the higher level of management
 - Training and developmental programmes and the feedback thereon

Other areas suggested to be covered in the report on performance analysis:

These are very comprehensive and could cover most of the aspects of enterprise performance. The auditor should make use of the non-financial measures of performance that signal the direction in which the future performance is being driven. The various non-financial measures are listed in List-B.

- ✓ Risk Analysis
- ✓ Environment and Sustainability
- ✓ Quality Performance:
- ✓ R&D Performance
- ✓ Business Process Performance
- ✓ Human Resource Accounting
- ✓ Value Added Analysis
- ✓ Performance of Intangible Assets
- ✓ Stakeholder Performance Analysis

Management accounting Tools:

The performance measurement involves collection of information, analyzing the same by establishing the inter-relations between them, interpreting the results and then arriving at meaningful conclusion. The collection of information depends upon various sources of data and other reports for various systems used by the organisation.

The data input is generally made in the accounting system used by the company eg the ERP systems. Most of the ERP systems facilitate input and capturing of even the non-financial data which can be then processed to produce desired reports. There is a lot of information to be accessed from outside of the ERP system. The auditor should identify such sources within and outside of the organisation and use information drawn from the same. The following table shows various management accounting tools that are used to serve different objectives:

Purpose	Management Accounting Tools
Control	Budgetary control, standard costing, variance analysis
Cost Computation	Full (absorption) Costing job, batch, process Or contract Activity based costing time Driven ABC.
Cost Reduction	Total Quality management, Quality costing Kaizen costing, manufacturing, Value Analysis and Value Engineering, Six Sigma
Pricing and decision making	Target costing, life cycle costing, Throughput accounting, variable marginal costing
Total performance management	Balanced Scorecard. Performance prism, performance pyramid Business Objects, Business Intelligence.

MANAGEMENT AUDIT IN DIFFERENT FUNCTIONS

Corporate objectives and culture

Corporate Objective:

- Corporate Objectives are the overall objectives of the organization that influence the direction of corporate strategy.
- In other words, what the organization seeks to achieve is corporate objective. These are the specific, realistic and measurable aims which an organisation plans to achieve. These represent the charter that the organisation has laid down for itself. These corporate objectives could either be written or unwritten.

Corporate Culture:

- Culture refers to a corporate's values, beliefs and behaviors on the basis of which people interpret experiences and behave.
- In simple language, corporate culture is the operating working environment and is shaped by the way people conduct their work, the way customers are treated and served, the way workers interact with each other or their supervisors or the way people present themselves.
- Culture is reflected in every activity, speech, habit, manners, behavior, action, dress etc., and in fact in every turn in the organization. Projection of good culture ensures a healthy corporate life. Management is not only a technique, it is also a culture.

Corporate Service Audit

- "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. These services co-ordinate the diverse organizational units and help them to focus on organizational goals by effectively exploiting resources and developing core competencies that enable an organization to keep its edge over its industry competitors.
- Corporate services are the support infrastructure of a company. These include public relations, customer assistance or call centers, training, engineering, human resources and procurement etc to create new business value and help the company function more effectively by improving internal processes, managing customer relationships and extending the organization.
- The advantages of corporate services are productivity gains, cost savings and service improvements. The benefits of these services extend to core business areas in form of reduced costs, less inventory, less working capital requirements, improved procurements, and higher profits. It also helps in much higher efficiency and productivity of the employees as new technologies can introduce an array of new possibilities with powerful

computers and integration of database with web technologies.

- The areas of corporate services audit and the scrutiny and evaluation criteria can be categorized as follows.
 - ✓ Consumers Quality goods in right quantities at right prices, place and time.
 - ✓ Employees Pay, training, safety, welfare, industrial relations, etc.
 - ✓ Shareholders Safety of investment, satisfactory return, capital appreciation.
 - ✓ Community Social cost and social benefit, public relations.
 - ✓ Fellow-businessmen Business ethics and fair-trade dealings
 - ✓ State → Compliance with the spirit of laws, fair trade practices, payment of taxes.

Corporate Development Audit:

- A corporate development audit is a comprehensive audit to assist the corporate management in various aspects of development through a process of systematic review and evaluation of long-term strategies of the company. Such a corporate development audit assures that.
- The various factors and forces constituting a corporate enterprise are the right kind and quality.
- Communication remains the key to the functioning of an enterprise.
- The pattern of departmentalization in an enterprise adopted in the past and proposed for the future for dealing with multidirectional responsibilities is fully responsive to circumstances and business environment.
- The personnel problems are handled appropriately considering the overall objectives of development of the corporate enterprise.
- The responsibilities of planning, coordination, motivation and control at functional management levels are discharged in proper spirit. vi.

Checklists in Areas of Corporate Development:

Checklists on various areas of corporate development may be helpful in appraising the structural aspect of a corporation, detailed below:

Check list on corporate planning:

- a. Whether SWOT analysis has been made?
- b. What are the corporate strengths and weaknesses in relation to price, product, quality, marketshare, distribution network, after sales services, technology improvement, corporate structure and qualities of its members?
- c. What are the opportunities and threats in relation to rivalry among existing firms, threat of new entrants, threat of opportunity of technical know-how, strategy of suppliers?
- d. How are the threats overcome and opportunities availed of in the past?
- e. Whether the "corporate image" is going to improve in near future?
- f. What specific techniques are applied by the management for corporate planning, long and short-term exercise?
- g. Whether the corporate objectives and goals are clearly defined and qualified?

- h. Whether the corporate planning premises and plans drawn up based on adequate information?

Checklist on corporate objectives

- Whether the corporate objectives are clear and explicit?
- Whether the different elements of the enterprise have separate objectives?
- How are these objectives defined? d. Are the objectives in writing?
- Is there sufficient flexibility in then organizational design in the form of the responsiveness to changes taking place from time to time?

Checklist on delegation of authority

- Whether there are clear lines of authority from top to bottom in the corporate enterprise?
- Whether accountability has been properly coupled with corresponding authority?
- Whether responsibility and authority in each position clearly defined in writing?
- Whether the number of levels of authority kept minimum?
- Whether duties assigned to the subordinates' indicative as to what exact activities are expected from them?
- Whether responsibility via delegation of authority created among the subordinates to complete the given task?
- Whether the methods of delegation compatible to the organization structure?

Checklist on span of control and management:

- Whether span of control has been recognized in the organization?
- Whether everybody in department report only to one superior?
- Whether the accountability of higher authority for the acts of its subordinates is in accordance with current practices?
- Whether the corporate management recognizes the following factors that affect span of control?
- Whether the different activities and functions are grouped together in order to-
- Whether responsibilities are grouped, wherever possible, so that overall control of a function can be established so as to hold the superior manager accountable?

Evaluation of Personnel Development

- "Personnel Management" is that part of the management function which is primarily concerned with the human relationships within an organization.
- Its objective is essentially the maintenance of those relationships, which enable all those engaged in the undertaking to make their maximum personal contribution to the effective working of that undertaking.
- Evaluation of personnel development may include the following criteria-
 - a. Pre-planning as an essential feature of human resource development.
 - b. Ascertaining manpower needs for appropriate education, training and development.

- c. Ascertaining the difference between future needs and existing talent Le. gap or imbalance.
- d. Adopting a suitable programme of recruitment, selection, training and development to close the gap of imbalance.
- e. Adequate manpower planning with an appropriate blending of manpower management policies and manpower management programme.
- The functional areas along with the scope of human resources management and development indicated below may be identified as the component of personnel function.
 - a) Organization review and analysis)
 - b) Manpower, planning, recruitment and selection
 - c) Manpower training and development
 - d) Performance appraisal
 - e) Employee remuneration
 - f) Employee services
 - g) Administration and records
 - h) Industrial relations
 - i) Auditing and research in manpower management

Consumer Service Audit;

- The primary responsibility of a business enterprise towards consumers is
 - a) To make available the products of the right quality available at the right time, in right quantity, at the right place and right price.
 - b) The consumer services audit critically examines and appraise management on these aspects of services.
- **Checklist on 'consumer services evaluation:** A management auditor while examining the consumer services policies and practices in an organization may use the following questionnaire:
 - a. **Products related policies and practices:**
 - Do the products manufactured meet the needs of the customers of different classes, different tastes and different purchasing power?
 - Whether the prices are reasonable and consistent with the quality variations, efficiency variations?
 - Whether the prices include reasonable profit?
 - Whether the prices have been fixed under competitive market or monopolistic conditions subject of Government restrictions?
 - Whether after-sales service spare parts facility etc. enable customers to derive maximum satisfaction?
 - Whether constant efforts are made for improvement of the product's use value as well as esteem value?
 - Whether such programme is undertaken to meet only the short-term demand or long-term requirements?
 - Whether the company policies and practices, relating to the distribution of products

among different sections of customers, fair and equitable?

b. Customer Relationship:

- Whether the customer complaints are handled promptly and efficiently?
- Whether the company responds quickly to the customers' enquiries relating to product or services?
- Whether the labels of the products contain adequate information to help the consumers to appreciate quality and other characteristics of the products?
- Whether the company cooperates with the groups and associations representing customers?
- Whether the company provides useful suggestions and renders necessary assistance to 'consumer's cooperatives' for distribution of quality goods at reasonable price?

c. General Considerations:

- Whether safety norms relating to products are maintained as per the accepted standards laid down by the statutory bodies, such as ISI, BSS, ETC.?
- Whether performance guarantees are explicitly stated?
- How do the merits of the company's own products match the advantages to the consumers, if mentioned in the advertisements?
- Whether the technical data given in the sale's promotional media specific and not ambiguous?
- Whether the policies and practices of the company are adequate to combat artificial scarcities?
- Whether all the "warranties" are explicitly stated? Is the procedure for invocation of warranty stated in unambiguous terms?
- Whether the fundamental aspect of servicing responsibility to consumer recognized by the enterprise as a policy measure?
- Whether there are instances of relaxation of policy norms in respect of responsibilities to customers even when the distribution of goods is made through middlemen?

Audit of Environmental Pollution Control

1. Meaning of Environment: Environment includes entire biological, physical and social milieu in which man and other organisms are placed and no organism however simple or complex can survive on their removal from the environment.

2. Environment Pollution:

- 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 crises and threats affecting the delicate balance of natural ecosystem? Pollution can be described in the following ranges:

- Pollution as any alteration of the environment.
 - Pollution as the right of the territorial sovereign (it indicates the limit of pollution allowed within geographical borders of a state).
 - Pollution as a damage to man and to the environment.
 - Pollution as interference with other uses of the environment
 - Pollution exceeding the assimilative capacity of the environment.
3. **Different Types of Pollution:** 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 as follows-
- a. Air pollution
 - b. Water pollution
 - c. Noise pollution
 - d. Smell pollution
 - e. Thermal pollution
 - f. Visual pollution
 - g. Climate pollution
 - h. Radiation pollution
 - i. Soil/land pollution

Energy Audit

1. **Meaning of Energy Audit:** Energy audit means monitoring the energy efficiency of different equipment and processes in a plant and looking into way by which the total sum of energy consumed can be cut down without affecting production or its efficiency.
2. **Aspects Covered:**
 - An energy audit is a fundamental step of the energy conservation programme in any industrial plant or energy consuming facility.
 - Energy utilization and conservation play an important role in an industry in the current scenario of rapidly diminishing fossil fuels, explosive rise in the prices of crude oil and other energy sources and a possible switch over to alternative source of energy both for conserving energy costs and towards attempt for alternative sources of energy.

Productivity Audit/Efficiency Audit:

Meaning of Productivity Audit: The Productivity audit is basically an analysis of the productivity of the resources (Money, men, machines, materials and methods) deployed by any organization.

Objectives: The following are the objectives of productivity audit:

- To attain optimum result,
- To improve on the benchmarks.

Aspects Covered: This audit would generally comprise:

- Comparison of expected returns on utilization of the resources vis-à-vis the actual

returns.

- Comparison of optimum returns on utilization of the resources vis-à-vis the actual returns; and
- The steps taken to improve benchmarks of returns and utilization.

Propriety Audit

1. **Meaning:** It refers to verification of transactions in the best interest of the public. commonly accepted customs and standards of conduct.
2. **Aspects to be covered:** The auditors, while conducting the propriety audit, should in any case ensure observance of the following Canons of Financial Propriety:
 - The expenditure should not, prima facie, be more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public money as a person of ordinary prudence would exercise in respect of expenditure of his own money.
 - No authority should exercise its power of sanctioning expenditure to pass an order which will be directly or indirectly to his own advantage.
 - Public money should not be utilized for the benefit of a particular person or section of the community unless:
 - ✓ The amount of expenditure involved is insignificant or
 - ✓ A claim from the amount could be enforced in a court of law or
 - ✓ The expenditure is in pursuance of a recognized policy or custom.
 - The amount of allowances (eg, travelling allowances) granted to meet the expenditure of a particular type, should be so regulated that these are not on the whole sources of profit to the recipients.

Corporate Responsibility Audit

1. **Constitution of CSR Committee:** As per Sec 135(1) of Companies Act, 2013, Every company having
 - a. Net worth of Rs. 500 crore or more, or
 - b. Turnover of Rs. 1,000 crore or more or
 - c. Net profit of Rs. 5 crore or more during any financial year
 - d. shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.
2. **CSR Expenditure.** The CSR Board shall ensure that the company spends, in every financial year, at least **2% of the average net profits** of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.
3. **CSR AUDIT PROCESS:**
 - 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
- **A CSR Audit should cover the following points:**
 - Human Rights
 - Business behavior
 - Human Resources
 - Corporate Governance
 - Environment
 - Community Involvement

Social Cost Benefit Analysis Audit

- **Meaning of SCBA Audit:** It refers to a methodical and rational process of identifying, evaluating and assessing the benefits (outputs) and costs (inputs) associated with alternative activities which will effectively accomplish economic targets and social goals."
- **Purposes:**
 - ✓ To determine and measure the expected future economic and social benefits that may be derived from an intended project or activity.
 - ✓ To determine and measure the flow of future economic and social costs that would be incurred to accomplish the benefits.
 - ✓ To ascertain the net benefits as a result of the above assessment
 - ✓ To decide as to which of the projects or activities will yield the maximum benefits about set economic standards and defined social goals for the national economy.
- **Basic Requirements of SCB Analysis:**
 - Identify and define the objectives of the project or intended activity.
 - Identify and measure the future benefits accruable-direct and indirect
 - Identify and measure the relevant costs-direct and indirect (and imputed)
 - Ascertain the present value of net benefits including the choice of a discounting factor.
- **SCB Analysis Techniques:**
 - UNIDO Methodology-Social internal rate of return.
 - Little and Mireles approach
 - Indian Planning Commission methodology.

INFORMATION SYSTEMS SECURITY AUDIT

Introduction:

- ✓ An information systems security audit (ISSA) is an **independent review** and **examination** of system records, activities, and related documents.
- ✓ ISSA is intended to
 - Improve the level of information security.
 - Avoid improper information security designs.
 - Optimize the efficiency of the security safeguards and security processes.
- ✓ **Objective:** Conducting regular ISSA can help identify weak spots and vulnerabilities in IT infrastructure, verify security controls, ensure regulatory compliance, and more

Steps in Information Systems Security Audit:

The following are the five important steps involved in conducting ISSA.

- **Step 01: Define the objectives:** In this phase. Audit team should Layout the goals that the auditing team aims to achieve by conducting the IT security audit.
- **Step 02: Plan the audit:** Define the roles and responsibilities of the management team and the IT system administrators assigned to perform the auditing tasks.
- **Step 03: Perform the auditing work:** The auditing team should conduct the audit according to the plan and methodologies agreed upon during the planning phase.
- **Step 04: Report the results:**
 - a. Compile audit-related documentation into a formal report that can be given to management stakeholders or the regulatory agency.
 - b. The report should include a list of any security risks and vulnerabilities detected in IT systems, as well as actions that IT staff recommend mitigating them
- **Step 05: Take necessary action for the deficiencies:** Follow through with the recommendations outlined in the audit report.

Differences between Security Audit and Risk Assessment:

1. Risk Assessment

- A risk assessment is often performed at the start of an IT initiative before tools and technologies have been deployed.
- It's also performed every time the internal or external threat landscape changes.
- In organizations with mature security processes, risk assessment is performed regularly to assess new risks and re-evaluate risks that were previously identified. The goal of a risk assessment is to determine how best to build IT infrastructure to address known security risks. Hence, this activity is focused on outward factors and how they affect infrastructure.

2. Security Audit

- A security audit is performed on an existing IT infrastructure to test and evaluate the security of current systems and operations.
- As a best practice, schedule security audits to be performed at regular intervals so that overall security posture is on an ongoing basis.
- Security Audit should follow the below mentioned best practices.
 - Establish Clear Objectives
 - Obtain Buy-in from Key Stakeholders
 - Define Clear Action Items Based on the Audit Results
 - Security Audit Solutions

Compliance and Security framework for banks:

The entire banking heavily relies on electronic platforms and online transactions, cyber security is imperative.

RBI also expects the Banks to report to the Cyber Security and Information Technology Examination (CSITE) Cell of the Department of Banking Supervision, with the following details.

- Gap analysis against the published Cyber Security / Resilience Framework
- Information security controls.
- Effectiveness of the implemented controls.
- Plan of action to mitigate risks.
- Role of Chief Information Security Officer.

Audit of Banks by RBI:

The RBI audit is performed as outlined below:

- The audit is conducted as an in-depth technical assessment.
- Includes information security process audit.
- Includes applicability of cyber security controls.
- By checking evidence and logs on servers.
- Includes checking all norms of technical requirements as per RBI.

RBI Audit Report:

- A detailed gap analysis report.
- The report will provide who needs to do what activities to be compliant with RBI.
- Wherever possible, the report will include details on what exactly needs to be done and by which team or person.

RBI Cyber Security Framework Domains

The Following are the Baseline controls stipulated by RBI for banks.

- ✓ Inventory Management of Business
- ✓ IT Assets Preventing execution of unauthorized software.
- ✓ Application Security Life Cycle (ASLC)
- ✓ Patch/Vulnerability & Change Management
- ✓ Vendor Risk Management.

- ✓ Removable Media.
- ✓ Maintenance, Monitoring, and Analysis of Audit Logs
- ✓ Audit Log settings
- ✓ Metrics
- ✓ Forensics
- ✓ Environmental Controls.
- ✓ Network Management and Security,
- ✓ User Access Control/Management
- ✓ Authentication Framework for Customers.
- ✓ Advanced Real-time Threat Defense and Management
- ✓ Anti-Phishing
- ✓ Vulnerability Assessment and Penetration Test.
- ✓ Red Team Exercises
- ✓ Incident Response & Management.
- ✓ User/Employee/ Management Awareness.
- ✓ Customer Education and Awareness.
- ✓ Secure Configuration.

Besides these controls, the Banks are mandated to implement controls based on their level as decided by RBL

- Level 1 Banks Cyber Security
- Level 2 Banks Cyber Security
- Level 3 Banks Cyber Security
- Level 4 Banks Cyber Security

Cyber Security Vs Computer Forensics:

✓ **Cyber Security:**

- a. Cyber security is a professional discipline that is about creating defensive measures to protect against cyber-attacks.
- b. The primary goal of any cyber security professional is to create a network or system that is impossible to breach, thereby protecting the information within the network.
- c. Cyber security is that it is almost entirely about prevention like ethical hackers.

✓ **Computer Forensics:**

- a. Computer forensics is the practice of recovering data from a device, often to uncover evidence of criminal activity.
- b. The practice itself is reactionary in nature. Computer forensics jobs either assist with an investigation or help people and
- c. companies recover data that has been lost.

IT Audit in Banking Sector:

- a. **Meaning:** IS audit evaluates the adequacy of the security controls and informs Management with suitable conclusions and recommendations. The

- b. **Overall objective:** The overall objectives of the normal audit exercise do not change, when applied to the computerized environment.
- c. **Objectives/Broad framework of IS Audit:** The major objectives of IS audit include, among others, the following:
 - Safeguarding of Information System Assets/Resources.
 - Maintenance of Data Integrity.
 - Maintenance of System Effectiveness.
 - Ensuring System Efficiency
- d. **Approaches of IS Audit:** The following are the three major approaches of IS
 - **Auditing around the Computer:**
 - i. The emphasis is on checking the correctness of the output data/documents concerning the input of a process without going into the details of the processing involved.
 - ii. This approach is preferred,
 - Where auditors themselves do not have the desired level of technical skills to adopt the other approaches.
 - When high reliance is placed on the users rather than the computer controls to safeguard the assets, maintain data integrity and attain effectiveness and efficiency objectives.
 - **Auditing through the Computer:**
 - The computer programs and the data constitute the target of IS audit.
 - Compliance and substantive tests are performed on the computer system, its software, and the data. IS auditors can test the application system effectively using this approach.
 - This approach is time-consuming, as it needs an understanding of the internal working of an application system.
 - **Auditing with the Computer:**
 - The computer system and its programs are used as tools in the audit process.
 - The objective is to perform substantive tests using the computers and their programs.
 - This method is used where
 - ✓ Application system consists of a large volume of inputs, producing a large volume of outputs.
 - ✓ Logic of the system is complex.
 - ✓ There are substantial gaps in the visible trails.
 - ✓ The IS audit documentation should contain the description of the CAAT application.
 - **Information Systems Audit Methodology:** Audit activity is broadly divided into 5 major steps for the convenience and effective conduct of the audit.
 - Planning IS Audit.
 - Tests of Controls

- Tests of Transactions
- Tests of Balances.
- Completion of Audit,

EVALUATION OF CORPORATE IMAGE

Introduction:

- ❖ Corporate Image is one of the most important aspects in the life of a corporate house. While conducting management audit a management auditor operating the series of checks should remember that many of checks are not compulsory but complimentary.
- ❖ Therefore, an absolute picture of the effectiveness of any single function may not be completely obtainable from review/checks in that particular area. Each management function should be seen as a balanced part of the whole organisation.

Audit Checks of different Managerial functions:

1. Directorial Checks:

- a. What routine reports are considered as directors' meetings and prima facie provide information for effective and efficient control of the business?
- b. Do the directors receive projected information covering the various functions of the business, in addition to any figures which they receive to enable them to review the present performance of the business?
- c. Is there evidence that directors established their control primarily on such projections secondarily on past records?
- d. Whether the Director review and approve the strategic and financial plans for achieving long-term success of the company.
- e. What is the directors' policy for ensuring that the right kind of senior managers including CEO are engaged?
- f. What interest do directors take in R&D? In particular, if formal R&D facilities are available, what significant efforts are made to relate these to market research?
- g. Have the directors set out the objects of the organization in writing?
- h. Are all activities of the organization within the scope of its objectives?
- i. Whether they have been briefed about major risks faced by the business and strategies for addressing these risks.
- j. Do these include the ratio of capital aimed to be employed in the business, the objectives earning per share, the planned growth of the latter and the control of the former?

2. Managerial Checks:

- a. Are all levels of managers competent in their functions?
- b. What evidence is there that managers are up to date in their particular function?
- c. Do all managers sufficiently and efficiently delegate their function?
- d. Are there any example of delegation to the point where control is lost?
- e. Are there adequately defined communication procedures?
- f. Is it possible to identify the management styles of the senior managers and assess their effectiveness?
- g. Is there an adequate definition of staff responsibilities?
- h. Is there a precise organizational structure?

- i. Is there a system of management by objectives?
- j. Are job specifications available for each or the majority of positions?

3. Organizational Checks:

- a. How effective is the coordination and integration of the various departments?
- b. Is there any evidence of duplication of function as between one department and another?
- c. What is the management information system and who is responsible for it?
- d. Is the information supplied well and logically presented in the various reports?
- e. What strengths and weaknesses of the organisation are revealed by scrutiny of the special reports?
- f. Do special reports in general evidence of critical appraisal?
- g. How is the budget structure related to operational responsibilities and how are expenditure controlled within the budget and remedial actions taken?
- h. How is inflation catered for in budgets?
- i. Is reporting based on the exception principle, or what other methods are used to highlight information areas requiring investigation?
- j. Has each manager defined the responsibilities of his staff?

4. Capital Checks:

- a. Is the working capital adequate?
- b. Is the capital employed the optimum for the business?
- c. What authorizations are required for the purchase of fixed assets and are they effective?
- d. Is there an up-to-date asset register, and how are the assets physically identifiable?
- e. How often is the asset register compared with the actual fixed assets position?
- f. Is the right amount of technical appraisal being made before the purchase of fixed assets?
- g. Is the equity and loan capital adequate of the business?
- h. How do the ratio of such capital compare with other business audited?
- i. What is the earnings ratio of such capital employed in the business?
- j. How do the earnings ratios compare with the business of the same type, in the same trade/federation, etc.?

5. Data processing Systems Checks:

- a. What are the main categories of data processing system? How are they divided between manual, mechanical and computer methods?
- b. Has the right balance between such methods being achieved over all?
- c. Are there adequate controls on the accuracy of all systems?
- d. Is use made of appropriate office techniques, such as photocopying, duplicating etc?
- e. Is such equipment the best of the particular purpose for which it is being used?
- f. Are the systems the best that can be devised?
- g. Are computer systems used where appropriate, for example, a minicomputer instead of a small selection of accounting machines?
- h. Is the computer installation appropriate in size and staffing?

- i. Who has access to the computer installations?
- j. Do programmers or system have any direct control of the data preparation unit?

6. Standard Procedure Checks.

- a. Do standard procedures exist and are they in writing?
- b. Who is responsible for keeping them up-to-date and are they in fact, so kept?
- c. Do they adequately reflect changes in organization or responsibilities that have occurred since the date they originated?
- d. To whom are they circulated?
- e. Are any checks carried out on behalf of general management to verify that the procedures are being adhered to?
- f. If so, who is responsible for carrying out such checks and to whom does he report?
- g. What determines whether it is the organization's policy in any set of circumstances to cover them by a standard procedure, eg. are standard procedures indicated if coordinated action is required by more than one department, or may they be confined to one department only?
- h. Are the standard procedures written as general instructions, leaving the details to be determined by individual department heads, or is every detail intended to be covered?

7. Planning function organisation checks:

- a. Who is responsible for overall planning within the organisation?
- b. If detailed planning is a staff function, what arrangements are there for making sure the planning does not get out of step with the planning policy makers?
- c. What arrangements are there for information feedback from the operating units to the planners?
- d. Is there a corporate planning unit?
- e. Is there a corporate stimulation model?
- f. If not, how far is stimulation used in the planning function?
- g. How accurate are the models?
- g. How are the various models kept up-to-date?
- i. To what use are the models put?
- h. Are environmental surveys carried out, and how is such information is used?

8. Purchasing function checks:

- a. Is there evidence that the purchasing budget is developing on sound lines?
- b. Is the budget, once prepared, used as an effective control on the purchasing function?
- c. Are 'make-or-buy' proposals made to ensure optimum supply arrangements?
- d. What is the system for synchronizing deliveries with the scheduled production requirements?
- e. What follow-up is there on scheduled deliveries?
- f. Is the receipt of goods adequately controlled?
- g. What procedures are there for dealing with over-deliveries and under-deliveries?
- h. Is there an effective system of inspection of materials received?
- i. Are 100 percent of the goods received inspected, or are they sampled, or what other inspection method is used?
- j. Are there similar routines to determine the supplier's relative ability to deliver on

time?

9. Inventory Control function checks:

- a. How are maximum and minimum stock controlled?
- b. What customer service level is required?
- c. How are these limits determined?
- d. Within the permitted overall value coverage of stocks, how are permitted quantities of each stock item determined?
- e. Is the stock of each item definitely related to the production program and the forecasted sales?
- f. Is stock control also a function of the economic batch quantities?
- g. How is raw material stock valued for production purposes and for balance sheet purposes?
- h. How is the issue of stock controlled?
- i. What are the systems of stock security?
- j. What are the procedures to be followed when stock is found to be defective in store?

10. Production Function Checks:

- a. How are the production requirements for raw materials communicated to the purchasing function?
- b. How is the production scheduled and controlled against the schedule?
- c. Are these methods suitable for the type, size and complexity of the production processes?
- d. What is the system for amendments to the production schedule?
- e. How is rescheduling carried out when production is not to schedule, or there are machinery or labor troubles?
- f. What methods are used to control the supply of raw materials for production?
- g. How are labor requirements determined?
- h. What system is there for ensuring good utilization for machinery and what statistics on this subject are available?
- i. Similarly, what is the system for ensuring good utilization of labor and what statistics on this subject are available?
- j. What is the inspection system during production and at the final product stage?

11. Marketing function Checks:

- a. Have clear marketing objectives been set? What are they?
- b. What plans have been developed to attain those objectives?
- c. What is the extent and nature of market research?
- d. What principles apply to product planning?
- e. What arrangements are there for the planning and control of packaging? How is the effectiveness of special sales promotions and advertising analyzed?
- f. Is the selling administration adequate for the type of market served?
- g. Are transport arrangements suitable for the average size of order, the type of customer served and the pattern of distribution?
- h. How is the sales force divided geographically, by specialization, according to

category of customer, or by any other method?

- i. How is the performance of salesman measured? Are short falls against targets identifiable to salesmen and specific customer?

12. Distribution function checks:

- a. Are there arrangements for deciding the most viable means of transport of finished goods?
- b. What are these arrangements? Are they well known by the transport staff?
- c. Did the arrangements result from some kind of the study of the transport problem and, if not, how were they developed?
- d. Has the limit of liability for claims on the various carriers in relation to the need of customers been considered in the choice of carriers?
- e. Have the economics of employing the company's own transport fleet been examined, particularly for high density and local deliveries?
- f. Has an attempt been made to compound claims with the carriers, so avoiding administrative expense in dealing with abortive paperwork and lengthy investigatory procedures?
- g. If the organisation uses its own transport fleet, have the pros and cons of contract hire or contract maintenance been considered?
- h. Are decentralized warehouses part of the distribution system? If not, have the possible benefits of such an arrangement been considered?
- i. Particularly where the organization's own transport and computer facilities are involved, has there been any attempt to optimize distribution patterns?

13. Financial Functions Checks:

- a. What are the credit control rules and are they being adhered to?
- b. Do the staff understand their service role to operational departments and also their own rules within the overall service function?
- c. What is the organization's policy on the acquisition and replacement of assets and the provision of funds for their replacement?
- d. How are fixed and movable machinery, etc. assets physically controlled?
- e. What evidence is there of effective security of accounting information, particularly that relating to personnel?
- f. How is the personnel expenditure authorized?
- g. How is the material expenditure authorized?
- h. How is fixed asset expenditure authorized?
- i. What controls are there on expenditure for labor
- j. Are the method of payment for goods economical and adequately controlled?

14. Personal function checks:

- a. How do staff measure up to this manpower specification?
- b. Has job evaluation been carried out throughout the organisation and what are the arrangements for evaluating new jobs as they occur?
- c. Do job specifications exist for all jobs in the organisation?
- d. Are adequate personnel records properly maintained at all times?

- e. If such records are kept centrally, what arrangements are there for access to them by remotemanagers and supervisors?
- f. Whether they personnel records kept in such a way that selection by employee characteristiccan be made therefrom?
- g. Is there an active training programme?
- h. Who is responsible for training managers
- i. What arrangements are there for the management development?
- j. Are adequate training records kept?

15. Management service function and data processing security checks:

- a. What services are covered by the department?
- b. Are the roles of the various specialists, their responsibilities, authorities and relationshipadequately defined?
- c. To whom does the head of the management services report?
- d. To whom does the head of the computer department report?
- e. Are the computer data preparation, operation, control programming and systems sections of the computer department independent of each other, reporting separately to the head of the computer department?
- f. Are the duties of each section clearly defined?
- g. Are there any opportunities for staff to carry out duties in a section other than their own?
- h. Who receives copies of such logs and are they carefully filled for future reference?
- i. Are operation research techniques practiced?
- j. Who controls operational research projects?

16. Equipment Checks:

- a. Who authorizes the purchase or rental capital equipment.
- b. What are the procedures for specifying equipment required in potential suppliers and for obtaining competitive quotations?
- c. In the case of equipment which have been replaced recently, or is about to be replaced relatively soon after acquisition, is there evidence that the original specification bore in mind reasonable development?
- d. In related equipment in different parts of or locations of the organisation compatible either formutual standby purposes or to facilitate the interchange of matter processed?
- e. Is the existing equipment compatible with likely or possible development of the concern?
- f. In large organisation, have special purpose or minicomputers been considered as viable as alternatives to the further use of a central computer?
- g. In particular, where large data inputs are considered, has a separate small computer been considered as a part of the data entry, editing and validating procedures, prior to data entry to a large processor?
- h. Is equipment being utilized adequately, eg, by shifts covering 24 hours a day, or by multiprogramming, spooling and/or virtual storage techniques?

- i. Are data collection systems too sophisticated for the needs of the business?
- j. Is the most efficient copying equipment for the particular needs and volumes of the business being used?

17. Methods and systems audit checks:

- a. What general control is there on methods and systems?
- b. How efficiently is this exercised?
- c. How are methods and systems knitted into the organizations?
- d. What detailed control is there on the implementation of a system?
- e. If the stages of implementation of a system are sufficiently critical and/or important, is advantage taken of such techniques as network analysis as one of the means of control?
- f. How are methods and systems maintained and documented? How is the documentation used in a new procedure explained to the users?
- g. How effective are any written standard procedures issued as a means of communication of systems requirements?
- h. Do they use common data wherever this is practicable?
- i. Do they supplement rather than oppose each other?

18. Security Audit checks:

- a. Is access to research and development areas controlled?
- b. Are the controls efficient and likely to be effective?
- c. In particular, is special attention given to the security risks involved in the entry of service personnel to research and development areas?
- d. What are the documentary and drawings security controls?
- e. Who is responsible for the security of the company assets?
- f. What measures are taken for the security of cash?
- g. How is cash transferred to the bank and how are collections of cash/bank handled?
- h. What systems are there for identifying and controlling movable tools and other assets?
- i. Who decides the actual route from the organization's premises to the bank?
- j. Is there a fixed asset register and who is responsible for maintaining it?

Audit checks of corporation divisions / departments

The audit checks of various corporate divisions/ departments include:

- Evaluation of Purchase Management
- Evaluation of Personnel Management
- Evaluation of Production Management Activities
- Evaluation of Research and Development
- Marketing Audit
 - ✓ Evaluation of Sales Management
 - ✓ Evaluation of Distribution Function

Evaluation of Purchase Management:

- a. What is the organisation for purchase function?
- b. Whether the purchase policy is realistic?
- c. How are suppliers selected and eliminated?
- d. Whether regular and dependable suppliers are ensured?
- e. Is there any system of purchase authorization?
- f. Whether latest market information automatically collected regarding new spares, etc.?
- g. Whether proper information is kept about price trends?
- h. Whether regular comparison is made between average price paid and the corresponding averagemarket price?
- i. What are built-in-controls against misutilization of purchasing powers?
- j. How effective is the system of follow-up?

Evaluation of personnel management:

- a. What is the organisation of the Personal Department ?
- b. Is the personnel department adequately staffed?
- c. What is the status of personnel manager in the organizational hierarchy?
- d. What is personnel policy? Is the organisation production-oriented or people oriented? How does the top management look at its employees?
- e. How are the manpower requirements assessed? Are manpower requirements defined clearly according to the degree of skills required?
- f. What is the requirement policy? Are qualifications for each job specified clearly? Is the requirement procedure well designed?
- g. What is the internal promotion policy? Are the employees given a chance to grow in the organisation itself through the objective tests to their qualifications and performances?
- h. Are training programmes conducted regularly? Are they effective in updating the knowledge and skills of the employees? Are the opportunities for training adequate?
- i. Are the training methods modern or scientific? Are they suited to the needs of the organisation?
- j. Are proper records maintained for all workers? Is time keeping effective?

Evaluation of production Management:

How quickly are the customers' complaints dealt with?

- a. Is the production design properly worked out? Is there a constant review of the production design to improve the cost-benefit ratio?
- b. Are the inputs and outputs of each process, operation or department linked up periodically?
- c. Does the input-output ratio conform with the standard ratio?
- d. What is the system of reviewing delays in production?
- e. What is the frequency of accidents? Are safety measures adequate?

- f. Is there a system of incentive scheme linked with the output of various production departments?
- g. Have the incentive systems been designed on the basis of scientific studies?
- h. How effective is control over idle time?
- i. Is the production process review done periodically to explore the possibility of having more efficient production method?
- j. Are the performances of service departments appraised periodically? Have standard efficiency factor worked out? Are they compared with actual efficiency ratios?
- k. How effective is the management information regarding production function as a whole?

Evaluation of Research and Development activities:

- a. What are strategic issues formulated at the Board level relating to industrial research?
- b. How does the company formulate its approach on the annual outlay on research and development?
- c. Whether the outlay on R&D is a fixed sum, a percentage of turnover, of profits, or capital investment, or on industry average?
- d. Whether the Board of Directors identify or endorse the broad "types of research to be undertaken to order to ensure that the efforts are concentrated in line with the defined goals?
- e. Whether the R&D is considered as an independent department in the company?
- f. Whether the R&D is viewed as a separate profit center?
- g. What is the level and extent of contribution of the company's profit through sale of technologies?
- h. Whether there is proper coordination between the R&D cell and corporate planning cell?
- i. Are the guidelines from the Board clear and workable?
- j. How is the R&D budget formulated?
- k. Whether the R&D results are properly recorded, classified and analyzed?

Marketing Audit:

- ✓ Marketing audit is an independent examination of the entire marketing effort of a company, or some specific marketing activities covering objectives, programme implementation, and organisation for purposes of determining what is being done, appraising which is being done, and recommending what should be done in future.
- ✓ The marketing audit covers the following areas.
 - a. Objectives
 - b. Programme
 - c. Implementation
 - d. Organisation

Evaluation of sales management:

- ✓ How is the sales department's organisation? Is it adequately staffed?

- ✓ How specific responsibilities fixed for development of products in various areas?
- ✓ What market forecasts are developed regularly? Are they reliable?
- ✓ How does the growth in sales during the last five years compare with that of the industry as a whole?
- ✓ What steps have been taken to increase the market share of the company?
- ✓ Whether the system of appraising performance of sales division and salesmen objectives fair?
 - Whether the salesmen's performance are linked with rewards?
 - Does the system motivate salesmen to give their best performances?
- ✓ Are the sales budget realistic? Do they show detailed physical targets for each sales office?
- ✓ What controls exist on the expenses incurred by salesmen?
 - What is the percentage of sales returns and allowances?
 - Whether the percentage of sales returns declined over the year?
- ✓ Is the system of after-sales services efficient?
- ✓ What is the frequency of customer complaining?

Evaluation of Distribution function:

For evaluation of distribution function a management auditor should consider the following

points -

- Customer service goals and objectives.
- Integrated material management.
- Physical distribution network and operating plan.
- Management information system.
- Allocation of work activities and effectiveness in discharging the function.

ESG Audit:

- i. India has introduced new environment, social, and governance (ESG) reporting requirements for the top 1,000 listed companies by market capitalization.
- ii. The SEBI stipulates that the disclosure must be made through Business Responsibility and Sustainability Report. BRSR reporting will be mandatory from Financial Year 22-23.
- iii. The following are the reporting requirements under this framework:
 - **Environment:** Businesses should respect and make efforts to protect and restore the environment and water) and intensity metrics
 - Resource usage (energy)
 - Air pollutant emissions
 - Greenhouse gas emissions
 - Waste generated and waste management practices.
 - Impact on biodiversity
 - **Social:** Businesses should respect and promote the well-being of all employees, including those in their value chains.

- i. **Employees:** Gender and social diversity, including measures for differently abled employees. Turnover rates, Median wages and Welfare benefits.
- ii. **Communities:** Social impact assessments, Rehabilitation and resettlement and Corporate social responsibility.
- iii. **Consumers:** Product labelling, Product recall, Consumer complaints concerning data and privacy, cyber security, etc.
- **Governance:** Businesses should conduct and govern themselves with integrity, and in a manner that is ethical, transparent, and accountable
 - Anti-corruption and anti-bribery policies
 - Awareness programs conducted for value chain partners on the principles in the RBC Guidelines
- iv. **Adoption of ESG:** Many leading companies in India have begun to include environmental, social, and governance targets as a part of key result areas (KRAS) for Top Management.

Illustration 1

A Company introduced a new product EZY with advanced technology in a product market where there is huge competition with many competitors having an individual market share of 5% to 10%. A survey of the present market estimates that demand will increase by 80,000 units per year. The company is presently targeting 50% of the additional market demand as competitors will need at least two years to match its product.

The Product EZY passes through three departments. Direct cost per unit of product at a present rate: Material cost 65 and Labour Cost ₹ 45. Overheads are absorbed based on normal capacity. The following relevant information is given:

Production Dept	Unit of Measurement	Normal monthly capacity	Monthly Allocated Fixed Overheads (₹)	Full Overhead cost Rate (₹)	Hours consumed by the product
X	Machine Hour	12,500 machine hrs.	₹ 50,000	10.50	2
Y	Direct Labor Hour	15,000 labor hrs.	₹ 60,000	9.00	1.5
Z	Direct Labor Hour	25,000 labor hrs.	₹ 75,000	6.00	3

The company has set a target of Selling and Distribution costs of ₹ 3,00,000 irrespective of sales volume. The company normally sets a price by adding a mark-up on costs between 30% to 40%.

You are required to suggest the price to take care of competition from the right perspective

Illustration 2.

ABC Co. has two Department producing small electrical goods. New Technology for the production of X will induce the following cost:

Costs	Department-A	Department-B
Direct Material	₹ 240	₹ 200
Direct Labor Rate / Hours	₹ 120	₹ 100
Direct Labor Hours	2 Hours	3 Hours
Variable OH Per Hour	₹ 50	₹ 30
Fixed Per Hour (Based on 100% Capacity)	₹ 60	₹ 40
Value of Machine on revaluation	₹ 40 Lakhs	₹ 28 Lakhs

New Technology cost = ₹ 25 lakhs, working capital = ₹ 7 lakh

The target volume of production in the 1st year is 2000 units @ 25% capacity

Variable Selling and Distribution Cost is ₹ 3 lakh for 2000 units. Expected return on investment 24%. Suggest pricing of a new product for a new one or the existing ones at 80% capacity.

Illustration 3

A company is operating at 60% capacity with a turnover of ₹ 86.40 lakhs.

- If the Company works at 100% capacity, the sales-cost relation is: Factory Cost is two-thirds of sales value and Prime Cost is 75% of Factory Cost.
- Administrative and selling expense (75% variable) are 20% of sales
- Factory overhead will vary according to operating capacity as given below

Operating Capacity	60%	80%	100%	120%
Factory Overhead (₹ Lakhs)	19.80	21.60	24.00	30.00

The company has planned to operate at 80% capacity. Moreover, it has received an export order and the execution of the same will involve 40 % of capacity. The prime cost of the order is estimated as ₹ 12.00 lakhs and the shipping expenses involved will be ₹ 2.00 lakhs. Taking the same percentage of profit on the domestic sale, determine the minimum price to be quoted for the export order.

Illustration 4.

ABC Co. has planned for an investment of ₹ 800.00 lakh with a 50% Loan from Banks at 10% interest.

Direct Cost for the year ₹ 480.0 lakhs and 50% of which is Material cost. Other expenses are at ₹ 80.0 lakh. The goods will be sold at 150% of the direct cost. The tax rate is assumed at 50%.

Determine:

- Net profit margin
- Return on Assets
- Assets turnover
- Return on owners' equity

(v) Inventory turnover

INTERNAL CONTROL, INTERNAL AUDIT AND OPERATIONAL AUDIT

Internal Control-Concept:

Internal Control means - Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment The internal control may be defined as the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations.

Objectives of Internal Control:

The main objectives of internal control are to ensure that

- transactions are executed in accordance with managements general or specific authorization.
- all transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;
- assets are safeguarded from unauthorized access, use or disposition; and
- The recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.

Scope of internal control:

An effective internal control system is a critical success factor for any organization in the long term. They are indispensable tools for the ever-increasing risks, exposures, and threats to accounting systems, data, and assets. It embraces the whole system of controls financial, operational or otherwise, established by the management in the functioning of a business including internal check, internal audit and other forms of control. In fact, internal control has now been recognized as fundamental and indispensable to modern auditing.

The internal controls can be broadly classified into following four main categories:

- **Administrative control** - Administrative controls include all types of managerial - controls related to the decision-making process. An example of administrative controls is the maintenance of records giving details of customers contacted by the salesmen.
- **Operational control** - This is exercised through "management accounting techniques viz. budgetary control, standard costing etc.
- **Financial and Accounting control** This control refers primarily the management plans, objectives and procedures that are concerned with the safeguarding of assets, prevention and detection of fraud and error, accuracy and completeness of accounting

records, and timely preparation of reliable financial information.

- **Compliance control** - These controls aim at ensuring compliance with applicable laws and regulations. These Controls also help to ensure compliance with laws regarding the system and intellectual property.

Structure of internal control:

There is no uniform or identical structure of internal control in all the organizations. It often varies in concept and applications, having regard to the following factors:

- Type of business
- Magnitude of the business
- Infrastructure available in the organization
- Potentiality of the human resources and their outlook.

Limitations of Internal Control:

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:

- Cost
- No control for unusual transaction
- Human Error
- Collusion among employees Abuse of authority.
- Inadequate procedure
- Manipulations by management

Evaluation of Internal Control:

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 constitute an Audit Committee:

- all public companies with a paid-up capital of Rs10 Crores or more
- all public companies having turnover of Rs100 Crores or more;
- all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs50 Crores or more.

The roles of the Audit Committee are:

- evaluation of internal financial controls and risk management systems;
- reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
- reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department. reporting structure coverage and frequency of internal audit.
- discussion with internal auditors of any significant findings and follow up there on;

- reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
- discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

Internal control and the auditor:

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 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:
 - ✓ The purpose of the audit was for the auditor to express an opinion on the financial statements.
 - ✓ 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
 - ✓ 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.

Internal Auditing-Evolution of the profession:

Internal Audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Necessity of Internal Audit:

The necessity of internal audit is as follows:

- Internal Audit assists management to improve internal controls by identifying weaknesses in systems and provides an opportunity to correct those weaknesses. Internal auditors

deal with issues that are important to the continued existence and prosperity of any organisation.

- It helps to detect errors and frauds and provides suggestions to improve them which help the management to take corrective action. .
- It detects the misuse of resources in time which helps to reduce unnecessary expenses .
- It increases the morale of honest staff because evaluation of the performance of any staff will be made at any time.
- Internal audit checks the books of accounts, detects errors and frauds and helps in its correction which makes the act of External/Statutory Auditor easier.
- It helps capacity building for organizational effectiveness.

Preparation for an audit:

- In general, the whole audit process involves the following:
- Defining the scope of the audit work, ie, preparation of the audit engagement letter.
- Obtaining the knowledge of the client's business and formulating the audit programme.
- Evaluation of the accounting and internal control system existing in the auditee enterprise.
- Determining the nature, timing and extent of audit procedures keeping in mind the audit risk and materiality involved.
- Adequate documentation is also necessary. i.e., preparation of audit notebook and working papers.
- Formulation of opinion about the financial statements.
- Issuance of audit report.

The auditor uses the following techniques to collect the necessary evidence:

- Vouching
- Confirmations
- Physical examination and observation Analytical procedures
- Test checking
- Inquiry
- Electronic data processing
- Preparation of reconciliation statements
- Flow charting
- Scanning

Audit Programme:

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.

Advantages of audit programme.

- 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.
- The 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 been no negligence on his part and he exercised reasonable care and skill while performing the task.

Disadvantages of audit programme

The main disadvantages of an audit programme are as follows.

- The auditor's task becomes mechanical, and the auditors may lose interest and initiative.
- Drawing up of an audit programme may be unnecessary for a small concern.
- Though audit programme helps in fixing responsibilities, but inefficient staff may defend themselves by stating that the matter was not contained in the audit programme.
- Rigid programmes cannot be laid down for each type of business.

Continuous and Final Audit

• Continuous audit

Continuous audit involves the detailed examination of all the transactions by the auditor continuously throughout the year or at regular intervals, say fortnightly or monthly. A continuous audit is one which is commenced and carried on before the close of the financial year to which it relates.

• Final audit

A final audit is also called as Completed Audit or Periodical Audit. Final audit is done after the close of the financial year, i.e. after the books of accounts have been closed and the final accounts are drawn up. In this type of audit, the client gives the possession of books of accounts to the auditor for audit and routine checking and other audit procedures begin only after that.

Audit Working Papers

Audit working papers are the record of the planning and execution of the audit engagement. Auditors retain a set of working papers for each audit engagement for each year. Working papers (or documentation) serve three purposes:

- aid in planning and performance of the audit,
- aid in supervision and review of the audit work; and

Operational Audit and Internal Audit under Companies Act, 2013

- These papers serve as evidence of the audit work performed by the auditor to support his opinion.

The form and content of working papers vary from audits to audits, but they are affected by the following matters:

- ✓ nature of engagement.
- ✓ form of audit report:
- ✓ nature and complexity of client's business,
- ✓ nature and condition of client's records
- ✓ degree of reliance of internal controls.
- ✓ Supervision of work performed by assistants.

Types of Working Paper Files:

Permanent Audit File	Current Audit File
Legal and organizational structure of the entity, e.g. MOA and AOA in case of a company.	Correspondence relating to acceptance of annual reappointment.
Extracts or copies of legal documents agreements and minutes relevant to the audit.	Extract of important matters in the minutes of board meetings and general meetings relevant to the audit.
A record of study and evaluation of internal controls	Copies of management letters.
Analysis of significant ratios & trends.	Analysis of transactions and balances.
Copies of the audited financial statements of previous year (s).	Copies of communication with other auditors, experts, and third parties
Notes regarding significant accounting policies.	Audit programme.
Significant audit observation of the earlier years.	Conclusions reached on significant aspects of audit.

Audit Notebook:

An audit book is usually a bound book in which a large variety of matters observed during the course of audit are recorded. The audit note book is a permanent record of the auditor

Contents of Audit Notebook:

- Name of the business enterprise.
- Organisation structure.
- Important provisions of Memorandum and Articles of Association.
- Communication with the previous auditor, if any
- Management representations and instructions.
- List of books of accounts maintained by the enterprise.
- Accounting methods, internal control systems followed by the enterprise,

- applicable laws etc.
- Key management personnel.
- Errors and fraud discovered.
- Matters requiring explanations or clarifications.
- Special points that need attention in the audit report and for subsequent audits.

Audit Engagement Letter:

Auditors agree with the client's management, in writing, about the scope, terms and conditions of the audit engagement. This written communication is referred to as an engagement letter.

The letter is usually addressed to chairman of the audit committee or, in the case of a corporation, the chair of the board of directors, with a copy being sent to the audit committee.

The purpose of such a letter is to minimize any possible misunderstanding concerning the scope and terms of the audit engagement.

Terms of Audit Engagement

- Agreeing the terms of the engagement with the client; and
- the auditor's response to a request by a client to change the terms of an engagement to one that provides a lower level of assurance.

Internal audit under Companies Act 2013:

The internal audit may contribute in the following areas

- Independent review and appraisal of control systems across the organization (both financial control systems and operational areas where the organization may reap benefits)
- Ascertainment of the extent of compliance of policies, procedures, regulations and legislations. Checking compliance management systems of an organization
- Facilitate good practices in management of risk. This requires systems for ascertaining measuring, managing and where possible mitigation or dispersion of the risk.
- Achieve savings by identifying waste, inefficiency and duplication of effort across the organization.
- Structuring programs and activities such that company assets are safeguarded and there are Internal check systems which minimize the possibility for reducing fraud / early warning signals for identifying fraud.

Compulsory requirement for appointment of Internal auditor(s) in listed and specified companies:

Section 138 read with rule 13 of the Companies (Accounts) Rules, 2014 provide that following class of companies shall be required to appoint an internal auditor or a firm of internal auditor; namely:

Operational Audit and Internal Audit under Companies Act, 2013

- ✓ every listed company
- ✓ every unlisted public company having:
 - paid up share capital of '50 crores or more during the preceding financial year, or
 - turnover of '200 crore or more during the preceding financial year, or
 - outstanding loans or borrowings from banks or public financial institutions exceeding 100crore or more at any point of time during the preceding financial year, or
 - which has accepted deposits of '25 crore or more at any point of time during the lastfinancial year, and.
- ✓ every private company having
 - turnover of two hundred crore rupees or more during the preceding financial year. Or
 - outstanding loans or borrowings from banks or public financial institutions exceeding onehundred 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 therequirements of section 138 and this rule within six months of commencement of such section.

Operational Audit:

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

Difference between internal audit and operational audit

Internal Audit	Operational Audit
Compliance objective	Risk identification, process improvement objective
Financial accounts focus	Business focus
Transaction-based	Process-based
Policies and procedures focus	Risk management focus
Cost Centre wise budget monitoring	Accountability for performance improvement results.
Methodology : Focus on policies, transactions, and compliance	Methodology: Focus on goals, strategies and risk management processes

AUDIT OF SERVICE ORGANISATIONS

Audit of Hospitals:

The following points are to be considered necessary for conducting an audit of the Hospital.

- Check the letter of appointment to ascertain the scope of responsibilities.
- Study the Charter or Trust Deed under which the hospital has been set up and take a special note of the provisions affecting the accounts.
- Examine, evaluate and verify the system of internal check, internal control and determine the nature, timing and the extent of the audit procedures.
- Vouch the entries in the Patient's Bill Register with a copy of the bill issued. Tests check the selected bills to see that these have been correctly prepared taking into consideration the period of stay of each patient as recorded in the Attendance Schedule.
- Vouch the collection from patients with copies of bills and entries in Bills Register. Arrears of dues should be properly carried forward and where these are deemed to be irrecoverable, they should be written off under due authorizations.
- Interest and/ or dividend income should be vouched with reference to the Investment Register and Interest and Dividend warrants.
- In the case of legacies and donations which are received for specific purposes. It should be ensured that any income therefrom is not utilized for any other purposes.
- Where receipts of subscription show a significant deviation from budgeted figures, it should be thoroughly inquired into and the matter be brought to the notice of the trustees or the Managing Committee.
- Government grants or grants from local bodies should be verified with the reference to the correspondence with the concerned authorities.
- A clear distinction should be made between the items of capital and revenue nature.

Audit of Hotels:

The following matters require special attention by the auditor:

- Internal Control
- Room Sales and Cash Collections
- Stock
- Fixed Assets
- Casual Labor
- **Other special aspects are to be verified as under**
 - a. Consumption shown in various physical stock accounts must be traced to the customers' bills to ensure that all issues to the customers have been billed.
 - b. All payments to the foreign collaborator, if any, are to be checked.
 - c. Expenses and receipts are to be compared with figures of the previous year, having regard to the average occupancy of visitors and changes in rates.
 - d. Special receipts on account of letting out of auditorium, banquet hall, spaces for shops, boutiques, and special shows should be verified with the

arrangements made.

- e. In depth check should be carried out on the customers' ledgers to verify that all charges have been properly made and recovered.
- f. The occupancy rate should be worked out, and compared with other similar hotels, and with previous year. Material deviations should be investigated.
- g. Expenses for painting, decoration, renovation of building, etc. are to be properly checked.
- h. It is common that hotels get their bookings done through travel agents. The auditor should ensure that the money is recovered from the travel agents as per credit terms allowed. Commission paid to travel agents should be checked by reference to the agreement on that behalf.
- i. Apart from control over stock of edibles, control over issue and physical stock of linen crockery, cutlery, glassware, silver, toilet items, etc. should be verified.
- j. The auditor should verify the restaurant bills with reference to KOT (Kitchen order Ticket).
- k. The auditor should ensure that all taxes have been included in the client's bills.
- l. Computation and payment of salaries and wages vis-a-vis number of employees must be checked.

Audit of Educational Institutions:

The special steps involved in the audit of an educational institution are the following:

- Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.
- Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- Check names entered in the Students Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test check amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
- Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing

Committee has taken a decision to the contrary.

- See that free studentship and concessions have been granted by a person authorized to do so, having regard to the prescribed Rules.
- Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.
- Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
- Verify rental income from landed property with the rent rolls, etc.

Audit of Co-operative Societies:

The special features of co-operative audit, to be borne in while conducting the audit, are as follows:

- Examination of overdue debts
- Overdue Interest
- Certification of Bad Debts
- Valuation of Assets and Liabilities
- Adherence to Co-operative Principles
- Observations of the Provisions of the Act and Rules
- Verification of Members' Register and examination of their pass books
- Special report to the Registrar
- Audit classification of society

Audit of Self-Help Groups:

- Self Help Group (SHG) Movement in India has been recognized as an effective strategy for mobilization and empowerment of rural people, particularly poor women and other marginalized groups. In India, Self Help Groups or SHGs represent a unique approach to financial intermediation.
- The approach combines access to low-cost financial services involving a process of self-management, with an objective of social and economic development for the women SHG members. Formations of SHGs are facilitated by the Government or by NGOs. SHGs are linked not only to banks but also to wider development programmes, SHGs are seen to confer many benefits, both economic and social.
- Applying the Field Balance Sheet Approach to Audit:
 - a. Background Review
 - b. Prepare Field Balance Sheet
 - c. Private Meetings with Members
 - d. Meeting with the SHG Group
 - e. Reporting

Audit of Non-Government Organizations:

- While planning the audit of a Non-Government Organisation (NGO), the auditor may concentrate on the following:

- Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.
- Reviewing the legal form of the organisation and its Memorandum of Association, Articles of Association, rules and Regulations
- Reviewing the NGO's Organisation chart, Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and Formats, budgetary policies, if any.
- 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.
- Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
- The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material is omitted:
 - Corpus fund
 - Reserves
 - Ear-marked Funds
 - Project/Agency Balances
 - Loans
 - Fixed Assets
 - Investments
 - Cash in Hand
 - Bank Balance
 - Stock in Hand
 - Programme and Project Expenses
 - Establishment Expenses
- The receipt of income of NGO may be checked on the following lines:
 - Contribution and Grants for projects and programmes.
 - Receipts from Fund arising programmes.
 - Membership Fees
 - Subscription
 - Interest and Dividends

Audit of local bodies:

- Local bodies are institutions of the local self-governance, which look after the administration of an area or small community such as villages, towns, or cities. The Local bodies in India are broadly classified into two categories. The local bodies constituted for local planning, development and administration in the rural areas are referred as Rural Local Bodies (Panchayats) and the local bodies, which are constituted for local planning, development and administration in the urban areas are referred as Urban Local Bodies (Municipalities)

- The objective of audit are
 - To report the content and presentation of financial statements are true and fair
 - Detection and prevention of error fraud, misuse of funds
 - To ascertain that full value received for money spent
 - Legal and administrative requirements fulfilled.
- The audit programme for local bodies include the following:
 - All sanctions are accorded by competent authority.
 - Expenditure incurred are according to provisions and as per regulations framed by competent authority.
 - Different schemes, programmes, and projects are running economically and the purpose such programme is achieved.

Audit of Government Expenditure:

- **Government Expenditure Audit:** Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by a competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below.
 - Audit against Rules & Orders
 - Audit of Sanctions
 - Audit against Provision of Funds
 - Propriety Audit
 - Performance Audit
- **Role of C&AG in the Audit of a Government company:** The auditor of a government company is appointed by the C&AG. 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,
 - ✓ to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorize in this behalf, and for the purposes of such audit, to require information or additional information to be furnished to person or persons so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may, by general or special order; direct.

Propriety Audit in the context of Government Audit:

Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

The expenditure should not be prima facie more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from

public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.

No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.

Public moneys should not be utilized for the benefit of a particular person or section of the community unless

- the amount of expenditure involved is insignificant or
- a claim for the amount could be enforced in a Court of law, or
- the expenditure is in pursuance of a recognized policy or custom; and
- The amount of allowances, such as travel allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

Audit of Commercial Accounts:

The government also engages in commercial activities and for the purpose it may incorporate following types of entities:

- Departmental enterprises engaged in commercial and trading operations, which are governed by the same regulations as other Government departments such as defense factories, mints, etc.
- Statutory corporations created by specific statutes such as LIC, Air India, etc.
- Government companies, set up under the Companies Act, 2013.

FORENSIC AUDIT

1. Meaning:

A forensic audit is an evaluation and examination of an individual's or a firm's financial records to stem up evidence that can be used in a legal proceeding or court of law.

- It is an independent, comprehensive, and scientific approach to reviewing an entity's financial statements. To determine its accuracy, free from material misstatement, evidence be used in a court of law or legal proceedings.

2. Reasons for Conducting a Forensic Audit:

- Forensic audit investigations may expose, or confirm, various kinds of illegal activities.
- Normally, instead of a normal audit, a forensic audit is used if there is a possibility that the evidence gathered would be used in court.
- The lawyers on both sides offer evidence that the crime is either discovered or disproved, which decides the harm sustained. They explain their conclusions to the defendant should the case go to trial before the judge.

3. Functions of Forensic Audit:

It comprises of the following steps:

- Planning the Investigation .
- Collecting Evidence
- Reporting
- Court Proceedings

4. Need for Forensic Audit:

In the following situations, the entity should direct forensic Audit.

- Theft of business information or where business systems have been hacked.
- Issues identified by Whistle-Blowers.
- Reconciliations resulted in unidentified material differences.
- Suspicious of fraud or illegal activity
- Turnover has occurred and balances are showing negative results.

5. Forensic Audit Procedures:

- Forensic audit should be conducted with an attitude of professional skepticism.
- Forensic Audit procedures are more towards detecting possible material misstatements in the financial records that result in fraudulent activities.
- Along with forensic data analysis fraud investigation techniques like triangle should be used for addressing three common elements of any fraud which are explained below:
 - ✓ Incentives- a motive that drives a person to commit fraud.
 - ✓ Attitude- an ability to rationalize fraudulent behavior.
 - ✓ Opportunity- that enables a person to commit fraud.

6. Investigation Methodology of Forensic Audit: An auditor can follow a nine-step method for fact-finding in case of forensic audit engagements:

- a. Accept the forensic audit engagement.
- b. Evaluate the allegations or suspicions.

- c. Conduct due diligence background notes.
- d. Complete the preliminary stage of the investigation.
- e. Check the prediction assuming that there will be litigation.
- f. Begin with an external investigation g Gathering the required proofs and evidence
- g. Preparing report on findings; and
- h. Court proceedings

7. Common Areas of Forensic Audit:

- a. Asset Misappropriation.
- b. Instances of Corruption.
- c. Extortion.
- d. Financial Statement Fraud
- e. Conflict of interest.

8. Reasons for Corporate or Business Frauds: The following are the major reasons for corporate or business frauds.

- The Desire or Perceived need to attract or Retain Investors
- Problems or defects with a Company's Products
- Due to raise in major Corporate Fraud Cases in the World like, Enron Company, Waste Management, ZZZZ Best Company and Wire card Company etc.

Fraud Risk Management:

1. Meaning of Fraud:

Fraud is a deliberate act (or failure to act) to obtain an unauthorized benefit, either for oneself or for the institution, by using deception or false suggestions or suppression of truth, or other unethical means, which are believed and relied upon by others.

2. Examples of Fraudulent Acts:

- Embezzlement.
- Unauthorized alteration or manipulation of computer files.
- Fraudulent financial reporting
- Forgery or alteration of documents and
- Conflict of interest, ethics violations etc.

3. Fraud Triangle: Employees who commit fraud generally can do so because of

- **Opportunity:** It is generally provided through weaknesses in the internal controls.
- **Pressure:** Motive to commit a fraud can be imposed due to Personal financial problems, Personal addictions or Unrealistic performance goals etc.
- **Rationalization:** It occurs when the individual develops a justification for their fraudulent activities.

4. Red Flags for Fraud:

- **Meaning of Red Flags:** These are warning signs that may indicate that fraud risk is higher without any evidence that fraud occurring.
- **Responsibility:** Managers and employees are responsible and should be aware of the red flags for fraud.

- **Inter Audit Department** :if multiple flags are present and accounting. irregularities or weakcontrols are identified, then the Internal Audit department should be contacted.

Financial Forensics and Forensic Audit Techniques:

a. Financial Forensics:

- Financial forensics is a field that combines accounting and investigation.
- The main purposes of financial forensics is discovering and gathering evidence of criminalactivity involving money.
- Financial forensics professionals help prevent financial crime and recover lost assets.
- The financial forensics professional, or forensics financial analyst, researches other businesses to determine their true value.
- Work areas for financial forensics professionals:
 - ✓ Financial theft
 - ✓ Securities fraud
 - ✓ Money laundering
 - ✓ Corporate valuation disputes
 - ✓ Tax evasion

b. Forensic Audit Techniques:

- In Modern days growth of companies has also increased in financial crimes and frauds
- Many businesses keep in house a separate department of accountants who keep an eye on all the business activities and strive to minimize any irregularities in the business's recordings. However, there are still cases of new and innovative fraudulent activities that can only be uncovered after an in-depth analysis of all the records and books of the business which lead to forensic accounting which is an **integration of accounting and investigative skills**.
- Forensic accounting not only helps the business minimize its losses but will also help improve the efficiency of the business.
- **Qualities a Forensic Accountant:** A Forensic Accountant should possess the following qualities.
 - Have a Logical Mind.
 - Give attention to detail
 - Give value to Moral Principles.
 - Question Everything /Inquisitiveness
 - Be Spontaneous Good understanding of Accounting transactions and impacts
- **Techniques for forensic accounting:** The following are the various innovative techniques forforensic accounting.
 - Reviewing Public Documents and Conducting Background Checks
 - Conducting Detailed Interviews
 - Gathering Information from Trustworthy Sources
 - Analyzing Evidence Gathered
 - Conducting Surveillance
 - Going Undercover

- Analyzing the Financial Statements

Ethical Considerations and Code of Conduct in Forensic Audit:

a. Ethical Issues in Business:

- Fundamental ethical issues in business include promoting conduct based on integrity and trust, but more complex issues include accommodating diversity, empathetic decision-making, and compliance and governance that is consistent with the organization's core values.
- To manage the ethical issues in business that arise in an organisation, first need to develop a thorough understanding of what those issues can look like, and detect them before they turn into problems.
- The following are various ethical issues that need to be addressed. Harassment and Discrimination in the Workplace
 - ✓ Age
 - ✓ Disability
 - ✓ Equal Pay
 - ✓ Pregnancy
 - ✓ Race
 - ✓ Religion
 - ✓ Sex and Gender
 - ✓ Health and Safety in the Workplace

b. Auditors-Ethical Standards:

- Fundamental principles include honesty or integrity, objectivity, professional competence, due care, and professional behavior.
- The following are that can potentially compromise the independence of auditors.
 - ✓ Self-Interest Threat
 - ✓ Self-Review Threat
 - ✓ Advocacy Threat
 - ✓ Familiarity Threat
 - ✓ Intimidation Threat
 - ✓ Resistance from employees
- Reduce ethics risk by taking these five key steps.
 - Honestly assess needs and resources.
 - Establish a strong foundation
 - Build a culture of integrity from the top down
 - Keep a "values focus" in moments big and small.
 - Re-evaluate and revise as needed.

Professional Opportunities:

- Growing cyber-crimes, failure of regulators to track the security scams, series of cooperative banks bursting all are pinpointing the need for forensic accounting. Forensic accounting seeks to uncover what, why, and how behind the computation and reporting of

figures. The aim is to ascertain or confirm the substance of those purported transactions.

- In India, Forensic Accountants are the most required in the wake of the growing fraud. The law enforcement officers are the experts in analyzing fingerprints and the optics but what about the digital evidence analysis.
- The Institute of Cost Accountants of India, Kolkata conducting Advanced Diploma in Forensic Audit which gives some insights on the subject and helps to improve the skills and knowledge in Forensic Audit.

ANTI-MONEY LAUNDERING

Introduction:

- Money laundering is the illegal process of making "dirty" money appear legitimate instead of ill-gotten.
- Criminals use a wide variety of money-laundering techniques to make illegally obtained funds appear clean.
- Online banking and cryptocurrencies have made it easier for criminals to transfer and withdraw money without detection.
- The prevention of money laundering has become an international effort and now includes terrorist funding among its targets.
- The financial industry also has its own set of strict anti-money laundering (AML) measures in place.

Meaning of Anti-Money Laundering

- Anti-money laundering (AML) refers to the activities financial institutions perform to achieve compliance with legal requirements to actively monitor for and report suspicious activities.
- In other words, it refers to the web of laws, regulations, and procedures aimed at covering efforts to disguise illicit funds as legitimate income.

Importance of Anti-Money Laundering:

- Tackling money laundering will assist in tackling crimes of all types.
- Money laundering can undermine the integrity of national economies and financial systems.
- Money laundering and associated corruption will corrode faith in democratic structures.
- AML procedures protect the most vulnerable members of society by helping to engender societies where crime is less prevalent and where financial inclusion is facilitated by accurate and reliable KYC processes.
- Channels into global financial systems have become deeply digitised, offering increased opportunities to money launderers for easy and more opaque movement of funds and to fraudsters for nefarious activity. In turn, this has created a market need for intelligent, flexible, and easy-to-use AML solutions and powerful yet accessible electronic identity verification solutions.
- UK AML strategies are particularly important because of its international financial role, the relatively liberal nature of its company formation regime, and the safe-haven status of its property market.
- Solid mature economies, with relative social stability, such as the UK will inevitably attract large-scale funds from overseas and internally. However, the very stability that underlines such attractiveness depends on ensuring that such funds are clean. So, apart from the obviously important points of regulatory necessity and the avoidance of penalty, communal

AML compliance is of benefit to all.

- Investment in compliance and compliance ecosystems is investment in customer trust and loyalty, and can be the means to peak long-term profitability, whilst ensuring business continuity, regulatory health, and brand security.

How Money Laundering Works:

- Money laundering is essential for criminal organizations that wish to use illegally obtained money effectively.
- Dealing in large amounts of illegal cash is inefficient and dangerous.
- Criminals need a way to deposit the money in legitimate financial institutions, yet they can only do so if it appears to come from legitimate sources.
- The process of laundering money typically involves three steps.
 - ✓ **Placement:** Placement surreptitiously injects the "dirty money" into the legitimate financial system.
 - ✓ **Layering:** Layering conceals the source of the money through a series of transactions and bookkeeping tricks.
 - ✓ **Integration:** In the final step, integration, the now-laundered money is withdrawn from the legitimate account to be used for whatever purposes the criminals have in mind for it.

Prevention of Money Laundering Act (PMLA). 2002;

- In India, The Prevention of Money-Laundering Act (PMLA), 2002 is an Act to prevent money laundering and to provide for confiscation of property derived from, or involved in, money laundering and for matters connected therewith or incidental thereto.
- Illegally obtained funds are laundered and moved around the globe using shell companies, and intermediaries.
- In this way, the illegal funds are given the color of legitimacy, and it finds their way into the economy.
- The Prevention of Money Laundering Act, 2002 consists of **ten chapters** containing **75 sections** and one Schedule. Money Laundering (Section 3):

Money Laundering (Section 3):

- ❖ The Act states that whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or actually involved in any process or activity connected with the proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it is an untainted property shall be guilty of offence of money laundering.

Proceeds of Crime (Section 2(1)(u):

- ❖ The term 'proceeds of crime' as to mean any property derived or obtained, directly or indirectly by any person as a result of criminal activity relating to a scheduled offence or the value of any such property or where such property is taken or held outside the country, then the property equivalent in value. held within the country or abroad.

Scheduled offence (Section 2(1) (y)):

- ❖ Scheduled Offence to include the offences specified under Part A of the Schedule, the offences specified under Part B of the Schedule if the total value involved in such offences is one crore rupees or more; the offences specified under Part C of the Schedule.

Property (Section 2(1)(v)):

- ❖ The term 'property' used in sub-section 1(v) of Section 2 means any property or assets of every description, whether, corporeal or incorporeal, movable or immovable, tangible or intangible and includes deeds and Instruments evidencing title to, or interest in such property or assets wherever located.

Attachment (Section 2(1)(d)):

- ❖ Sub-section 1(d) defines attachment as to mean prohibition of transfer, conversion, disposition, or movement of property by an order issued under Chapter III.

Attachment of property involved in money laundering (Section 5):

- ❖ Section 5 of the Act authorizes the Director or any officer not below the rank of Deputy Director authorised by him and who has reason to believe on the basis of material in his possession that any person is in possession of any proceeds of money laundering:
- ❖ such person has been charged of having committed a scheduled offence and such proceeds of crime are likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to confiscation of such proceeds of crime to, provisionally attach by order in writing such property for a period not exceeding 180 days from the date of the order.
- ❖ The said provisional attachment does not debar the person who has the possession of the property from enjoying the same but the said person is prohibited from creating any third-party interest in the said property.
- ❖ The Director or any other officer who provisionally attaches any property is required to forward a copy of the order along with material in his possession to the Adjudicating Authority immediately and thereafter required to file, within a period of thirty days from such attachment file a complaint, stating the facts of such attachment before the Adjudicating Authority.

Summon, Searches and Seizures, etc (Section 16, 17, and 18):

- ❖ **Section 16** empowers an authority to enter, on having reason to believe that an offence under Section 3 has been committed, any place within the limits of the area assigned to him or in respect of which he is authorised. Section 16(3) requires such authority to place marks of identification on the records inspected by him and make or cause to be made extracts or copies therefrom, make an inventory of any property checked or verified by him and record the statement of any person present in the place which may be useful for, or relevant to,

any proceedings under the Act.

- ❖ **Section 17** empowers authority to search and seizure.
- ❖ **Section 18** of the Act deals with search of persons and provides that if an authority authorized in this behalf by the Central Government by general or special order has reason to believe that any person has secreted about his person or in anything under his possession, ownership or control any record or proceeds of crime which may be useful for or relevant to any proceedings under this Act, he may search that person and seize such record or property which may be useful for or relevant to any proceedings under this Act.

Arrest Under PMLA (Section 19):

- ❖ Under Section 19 of PMLA, the Director, Deputy Director, Assistant Director, or any other officer authorized on this behalf by the Central Government by general or special order, has the power to arrest a person. A person can be arrested by the concerned authority, if such authority, is based on material in his possession, Has reason to believe that such a person has been guilty of an offence punishable under PMLA, and The reason for such belief has been duly recorded in writing
- ❖ After arresting such a person, the authority is bound to: Inform the arrested person about the grounds for his arrest. Forward a copy of the arrest order along with the material in his possession to the Adjudicating Authority. Produce such person, within twenty-four hours, before the Special Court or Judicial Magistrate or a Metropolitan Magistrate, as the case may be, having jurisdiction.
- ❖ From the bare perusal of Section 19 of PMLA, it is apparent that there is no requirement under the section to obtain an arrest warrant from the Court before arresting a person. If the conditions mentioned in Section 19 of PMLA are fulfilled, the relevant authority under PMLA can arrest such a person.
- ❖ The question of whether the offences under PMLA are cognizable or non- cognizable is irrelevant under PMLA. However, there are contradictory judgments of High Courts on the point of whether the offences under PMLA are cognizable or non-cognizable. The matter is now sub-judice before the Hon'ble Supreme Court.

Retention of records (Section 21):

- Where any records have been seized, under section 17 or section 18 or frozen under sub-section (1A) of section 17 and the Investigating Officer or any other officer authorised by the Director in this behalf has reason to believe that any of such records are required to be retained for any inquiry under this Act, such records may if seized, be retained or if frozen, may continue to remain frozen, for a period not exceeding one hundred and eighty days from the day on which such records were seized or frozen, as the case may be.
- The person, from whom records seized or frozen, shall be entitled to obtain copies of records.
- On the expiry of the period specified under sub-section (1), the records shall be returned to the person from whom such records were seized or whose records were ordered to be

frozen unless the Adjudicating Authority continuation of freezing of such records beyond the said period. permits retention

- The Adjudicating Authority, before authorizing the retention or continuation of freezing of such records beyond the period specified in sub-section (1), shall satisfy himself that the records are required for the purposes of adjudication under section 8.
- After passing of an order of confiscation or release under sub-section (5) or subsection (7) of section B or Section 58B, the Adjudicating Authority shall direct the release of the records to the person from whom such records were seized.
- Where an order releasing the records has been made by the Court, Adjudicating Authority under section 21(5), the Director or any officer authorised by him in this behalf may withhold the release of any such record for a period of ninety days from the date of such order, if he is of the opinion that such record is relevant for the appeal proceedings under the Act.

Presumption in Inter-connected Transactions (Section 23):

- ❖ Section 23 of the Act deals with presumption in inter-connected transactions and provides that where money laundering involves two or more transactions and one or more such transactions is or are proved to be involved in money laundering, then for the purposes of adjudication or confiscation under Section 8, it shall be presumed that the remaining transactions form part of such interconnected transactions, unless otherwise proved to the satisfaction of the Adjudicating Authority.

Presumptions & Onus of Proof (Section 24):

- ❖ Under section 24 of PMLA, the burden of proof lies on the person who claims that the proceeds of the crime alleged to be involved in money-laundering are not so involved.
- ❖ The presumption against the accused or any 3rd party is good enough to discharge the onus of the authorities under PMLA.
- ❖ Even in the case of records and properties which are found in the possession or control of any person in the course of a survey or search under PMLA (Section 16, Section 17, and Section 18), under section 22 of PMLA, a presumption is raised that such records or property belongs to such person. and the contents of such records are true, and further that signature and any part of such records is in hand-writing of a particular person or the hand- writing of such person.
- ❖ Where any records have been received from any place outside India, duly authenticated by such authority or person and in such manner, as may be prescribed, in the course of proceedings under PMLA, the Special Court, the Appellate Tribunal, or the Adjudicating Authority, as the case may be, shall presume, that the signature and every other part of such record which purports to be in the hand-writing of any particular person or which the Court may reasonably assume to have been signed by, or to be in the hand-writing of, any particular person, is in that person's hand-writing; and in the case of a record executed or attested, that it was executed or attested by the person by whom it purports to have been so executed or attested.

Offences to be cognizable and Non-bailable (Section 45):

- ❖ Section 45 declares every offence punishable under the Act to be cognizable. It provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, no person accused of an offence under this Act shall be released on bail or on his own bond unless the Public Prosecutor has been given an opportunity to oppose the application for such release; and where the Public Prosecutor opposes the application, unless the Court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while in bail.
- ❖ Provided that a person, who, is under the age of sixteen years, or is a woman or is sick or infirm, or is accused either on his own or along with other co- accused of money-laundering a sum of less than one crore rupees may be released on bail, if the Special Court so directs.
- ❖ Section 45(1A) provides that notwithstanding anything contained in Code of Criminal Procedure, 1973 or any other provision of this Act, no police officer shall investigate into an offence under this Act, unless specifically authorized, by the Central Government by a general or special order, and subject to such conditions as may be prescribed.