

COST AND MANAGEMENT AUDIT

CMA SHIVA

CMA FINAL

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COST AND MANAGEMENT AUDIT

PART-1 COST AUDIT

CHAPTERS

1. Basics of cost Audit
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3. Cost Auditor
4. Cost accounting standards
5. Cost Auditing Standards
6. Cost Audit programme
7. Cost Audit Documentation, Audit, process, execution
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9. Basics of management audit
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CHAPTER -1

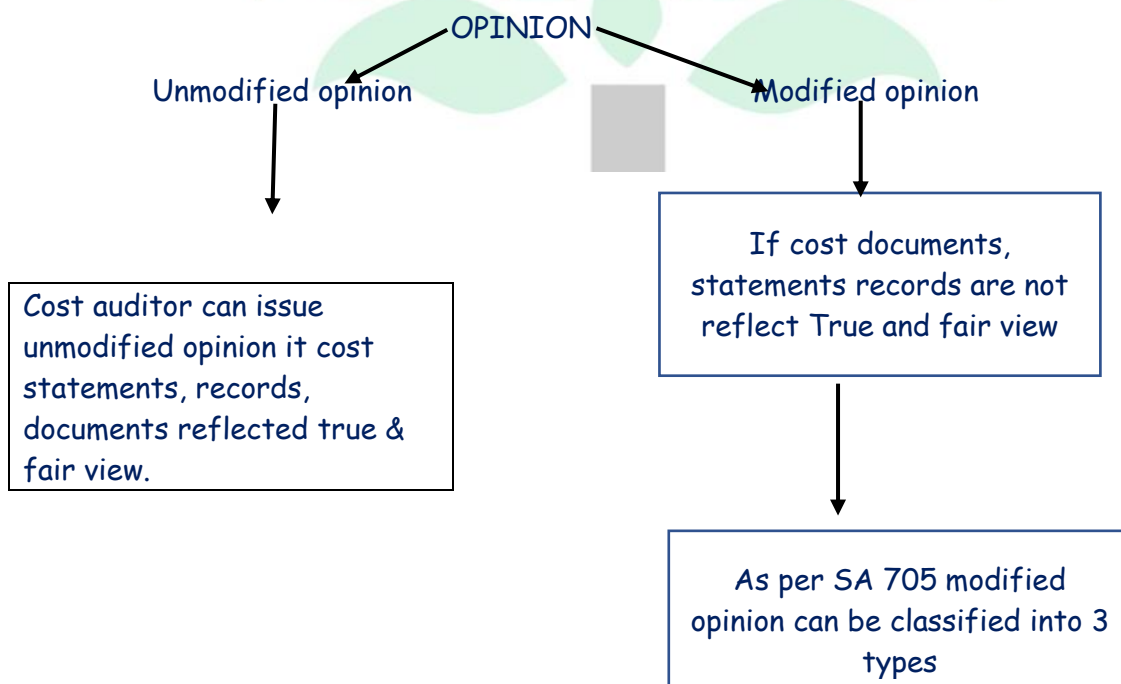
BASICS OF COST AUDIT

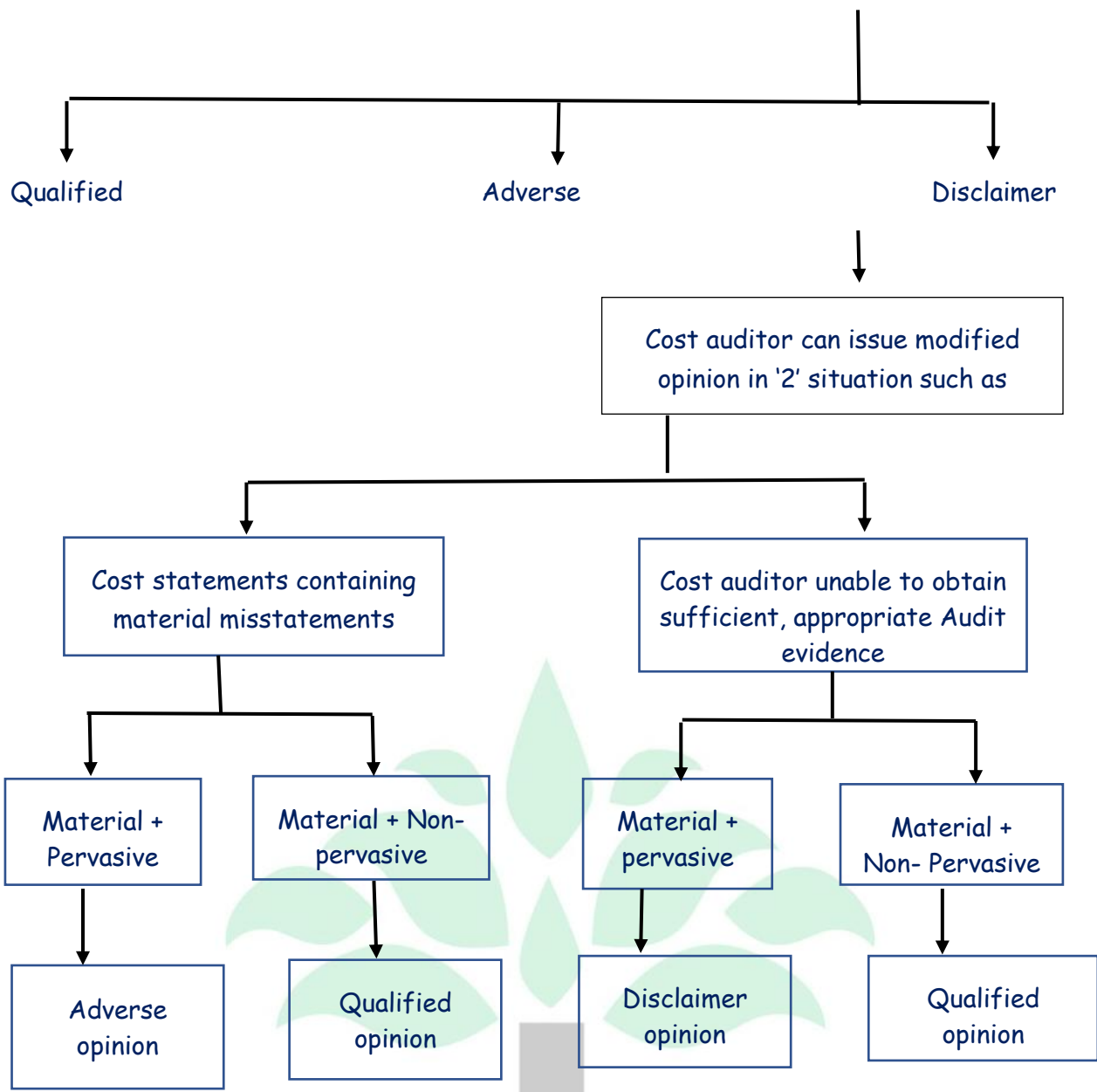
Topics to be covered:-

- 1) Meaning of cost Audit
- 2) Origin / History of cost audit
- 3) Relevance of cost audit
- 4) Objectives of cost audit
- 5) Legal framework for maintaining past records & conducting cost Audit.
- 6) Eligibility, Qualification, Disqualification of cost Auditor

Meaning of cost Audit:-

- i. Cost audit involves examination of cost book; statements, records related to company (or) Subsidiary company (or) associate company with a view to express an opinion on cost documents.
- ii. Opinion is based on whether cost documents is reflected true and fair view or not
- iii. Generally cost auditor opinion can be classified into two types such as
 - Modified opinion
 - Unmodified opinion





- Generally, cost audit will be helpful to know or settle disputes.

Relevance of cost Audit (or) Importance of Cost Audit

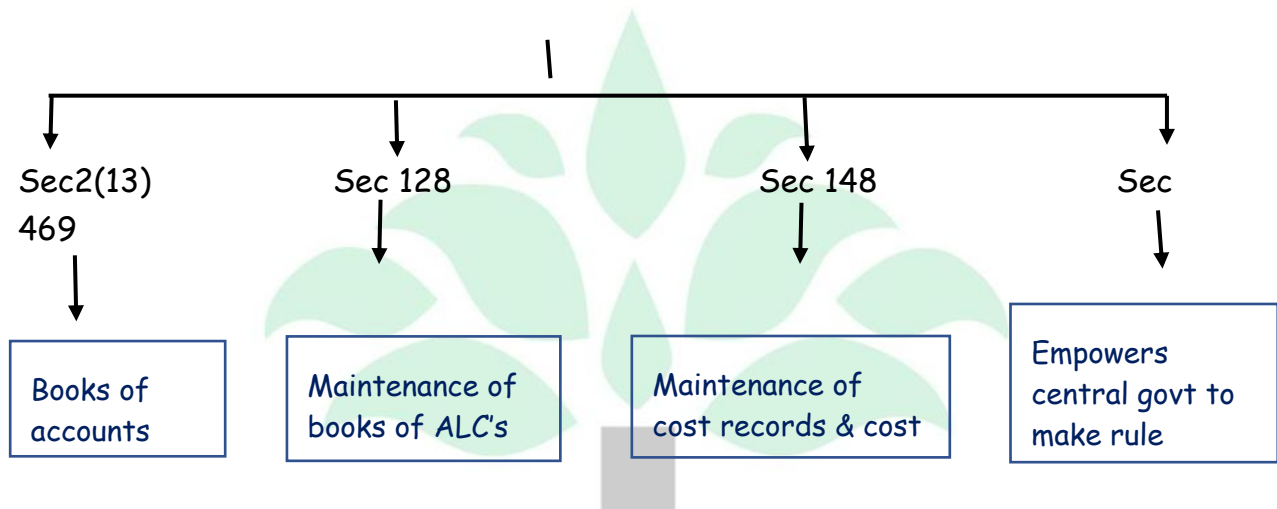
- Expert committee opinion that cost Audit situation in any country
 - i. Enable the organization cost structure.
 - ii. Tool of assessing organisational performance growth is based on profit.
 - iii. Cost audit will be helpful for decision making.

Objectives of the cost Audit

- i. Cost audit will be promote the cooperate governance through various operations discloses.

- ii. Determine of Inventory valuation.
- iii. Verification of cost per unit (or) profit per unit, selling price per unit by applying of elements of costing & methods of costing.
- iv. Facilitating fixation of selling price.
- v. Ensuring optimum utilisation of resources of the organization (with the help of operations costing OM Transportation, facility layout linear programming)
- vi. Periodical reconciliation b/w accounts and costing.
- vii. Detection of errors and frauds.
- viii. Verification of costing documents, statements.
- ix. Detection of abnormal loss of material, labour
- x. Advising to the managements for inter firm comparison (on the basis of costing records).

Legal Framework for maintenance of cost records & cost Audit



Sec 2(13) - Books of Accounts:-

Books of accounts means books of accounts which includes records in relation to

- Receipts & payments A/c
- All purchase and sale A/c
- All assets & liabilities
- Any other item of cost as may be prescribed by CG

Sec 469 :- Empowers of central government to make the rules

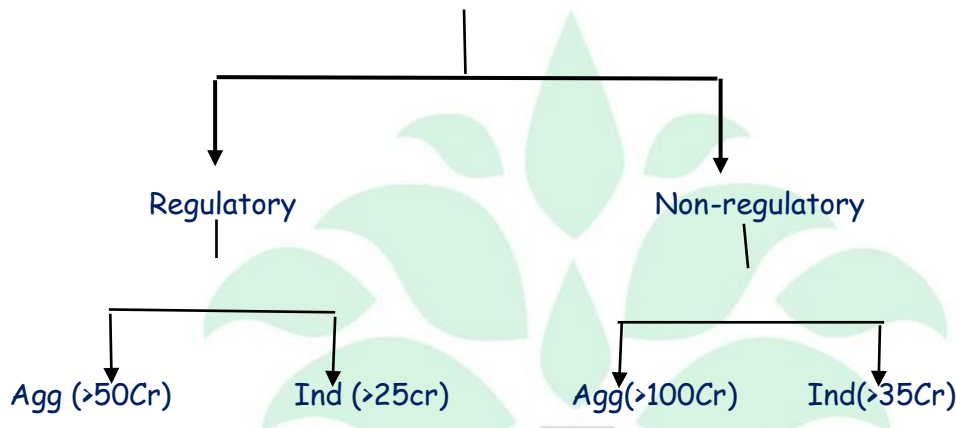
CG having authorization may make rules for carrying the provisions of the act

Sec128 :- Maintenance of books of accounts

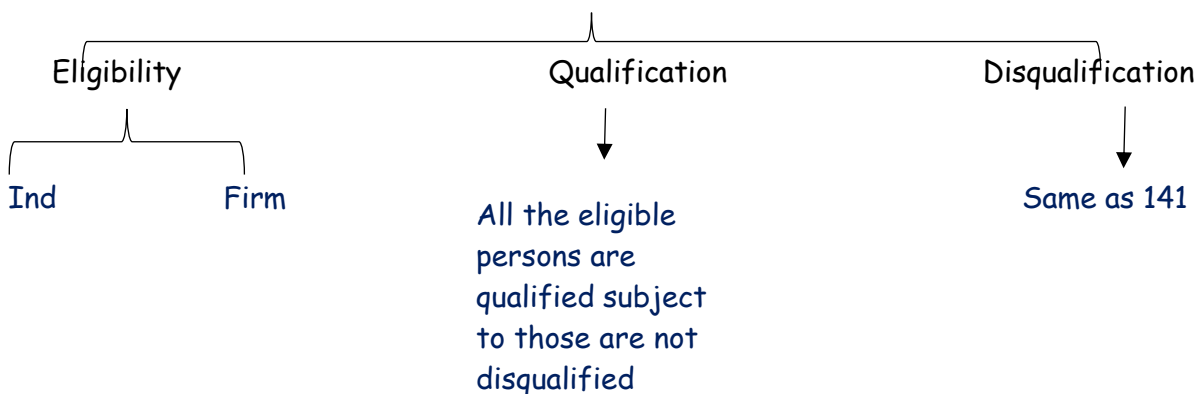
- Every co should be maintain books of accounts.
- Branch accounts should be communicated to registered office in a summarized manner.
- Books of accounts should maintain by company at any other place other than register office subject to board resolution passed by the company, board resolution should be submitted to ROC.
- BOA shall be maintained for 8 years

Sec 148:-

- Every co should maintain costing records subjects to conditions that CG shall specify/ notify
- However CG having power to notify subjects to conditions that turnover exceeds 53 crores.
- Cost Audit is mandatory for every co Subjects to conditions that
 - i. CG ordered maintaining of costing books mandatory.
 - ii. Company turnover exceeds



Eligibility , Qualification, Disqualification of cost Auditor



CHAPTER - 2

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

CHA 1 :- Maintenance of cost records

CHA 2 :- Intimation to central govt

CHA 3 :- Cost audit report

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

Rule:1 Short tittle, commencement

- Short tittle = companies 9cost records & audit) Rules 2014
- These rules are implemented in India w.e.f 30/6/14

Rules2 :- definitions

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

Rules3 :- Application of cost records

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

Rules4 :- 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 are more during preceding year. And
 - Turnover from products manufacturing are services rendering which covers under table A (regulated sector) or under table B (un-regulated sector) or both should be ₹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) For remaining 33 un-regulated sector, 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	6C	9C	13C	15C	28C	No	No
2	8C	8C	26C	16C	42C	Yes	No
3	18C	8C	26C	26C	52C	Yes (A)	Yes (A)
4	18C	18C	28C	36C	64C	Yes (A)	Yes (A)
5	20C	25C	65C	45C	110C	Yes(A&B)	Yes(BOTH)
6	38C	0	65C	38C	103C	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:-

- 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.

Rule5 : 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 in form 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 recipient 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 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.

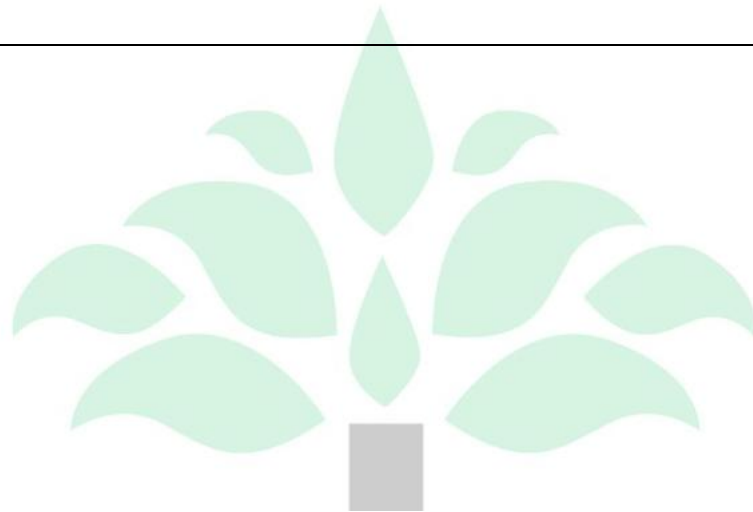
Para	Content
1	Quantitative details of capacity
2	Abridged cost statement.
2A	Details of material consumed.
2B	Details of utility.
2C	Details of industry specific operating expenses.

-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.



CHAPTER - 3

COST AUDIT DOCUMENTATION AND AUDIT PROCESS

- Cost Audit documentation:- Cost Audit documentation means the material including working papers by the cost auditor and retained them, by him during performance of the audit.
- Audit file:- Audit file means one or more folders or other stage media in physical or in electric form, containing the records that compare the audit documentation for a specific assignment or audit.
- 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.
- Audit stages :- The stages of an audit of cost statements are as follows:-
 1. Planning
 2. Performing
 3. Reporting

Planning an audit - first stage:-

- 1) "It is well said that a well planned audit is almost half way done."
- 2) The planning stage involves determination of audit strategy as well as identifying the nature and the timing of the procedures to be performed.
- 3) This is done to optimize efficiency and effectiveness when conducting an audit.
- 4) Efficiency refers to the amount of time spent in gathering audit evidence. Effectiveness refers to the minimisation of audit risk.
- 5) A well-planned audit will ensure that sufficient appropriate evidence is gathered to minimized at the cost statement level.

Performing an audit - second stage:-

- 1) The performance or executive stage of the audit involves detailed testing of internal controls, materials consumption, collection, apportionment and absorption.
- 2) If an auditor plans to believe on their clients system of internal controls then they will conducts tests of controls.

- 3) Cost auditor will conduct detailed substantive tests of audit procedures for the period and detailed substantive tests of consumption and balances recorded at the period end.
- 4) This detailed testing provides the evidence that the cost auditor requires to determine whether the cost statements have been fairly presented.

Concluding and reporting on an audit - final stage:-

- The final stage of the audit involves drawing conclusion based on the evidence gathered and arriving at an opinion regarding the fair, presentation of cost statements. The cost auditor's opinion is expressed in the cost audit report.
- At this stage of the audit, a cost auditor will draw on their understanding of the client, their detailed knowledge of the risks faced by the clients, and the conclusions, cost heads, items of cost and related disclosures.

-Practical steps of audit process:-

Step 1 :- Objectives of audit and management outlook:-

First step of cost audit is to achieve following objectives:-

- (i) Cost optimization or cost reduction.
- (ii) Checking parameters of operational efficiency of a unit.
- (iii) Suggesting product diversification or changed product- Mix.
- (iv) Identifying profit making or loss making products.
- (v) Suggesting changed marketing strategies, market expansion, market diversification.
- (vi) Complete review of business strategies.

Step 2 :- Pre-conditions:-

Following things should be understood by cost auditors:-

- 1) Objectives of cost audit.
- 2) Area, nature and scope of audit.
- 3) Number of cost auditors appointed.
- 4) The applicable reporting framework.
- 5) The reporting period.
- 6) The statutory deadlines.

Step 3 : Understanding the company's business:-

- (i) The cost auditor is required to understand the company's business its corporate structure and various systems being followed general details.
- (ii) Internal control system and Internal audit system followed by company.
- (iii) Accounting and cost accounting system and policies followed by company.
- (iv) Previous cost Auditor's report should also be read by such cost auditor.

Step 4 :- Planning the Audit:-

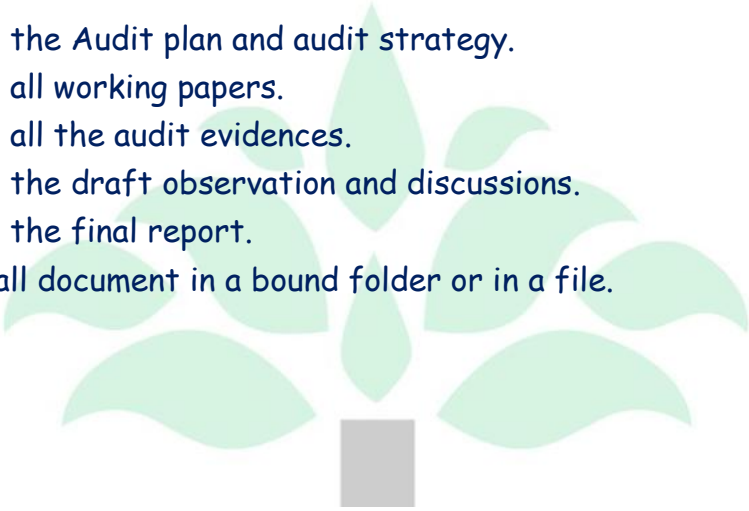
Planning of cost audit includes:-

- (i) Timing (dates) and duration (no of days) of audit period.
- (ii) Level and number of deployed personnel to be deployed.
- (iii) Audit partner to be developed (his expected days and dates)
- (iv) Drawing up on overall audit plan and audit strategy.
- (v) Document the audit plan and share it with the company.
- (vi) Ensure all the process should be followed properly.

Step 5 :- Executive of audit:-

- a) Perform the audit checks procedures as per planned.
- b) Collect all required audit evidence enabling the auditor to form his opinion.
- c) Prepare draft observation and discuss with key management personnel.
- d) Prepare final audit report.

Step 6 :- Audit documentations:-

- a) Document the Audit plan and audit strategy.
 - b) Document all working papers.
 - c) Document all the audit evidences.
 - d) Document the draft observation and discussions.
 - e) Document the final report.
 - f) Preserve all document in a bound folder or in a file.
- 

CHAPTER - 4

COST AUDITOR- PROFESIONAL ETHICS AND RESPONSIBILITIES.

- Code of ethics to be followed of a cost auditor:-

As professionals in the fields of cost and management accounting , the members of our institute are bound by a code of professional ethics.

Such code of ethics are bound them to the highest level of care duty and responsibility towards their employees, clients, public and their fellow professionals.

Following are the such code of ethics:-

- i. Integrity:- a cost accountant should be straight forward and honest in performing his services.
- ii. Objectivity:- A cost accountant should be fair and should not allow prejudice or bias or influence of others, which override their objectivity.
- iii. Competence:- A cost accountant must refrain from performing any service which he is not competent to carry out such service. All the services must be performed after proper advice and assistance is obtained to ensure that the service is performed to the satisfaction.
- iv. Confidentially:- 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.
- v. Professional behaviour:- A cost accountant should act in a manner consistent with the good reputation of the profession.

Section 143 of companies act, 2013 : Duty of a cost

1. If the cost auditor has reasons to believe that an offence involving fraud is being or has been committed against the company by its officers and employees then cost auditor shall immediately report such fraud to the central government.
2. Fraud reporting to the central government shall only be made in case of amount involving Rs 1cr or more.
3. It means cases having amount less than Rs 1cr have to report to BOD or to Audit committee within 2 days.

4. After reporting to BOD or to audit committee, the cost auditor have to wait for a period of 45 days for a reply from them.
5. Otherwise cost auditor shall report about such fraud to the central government,
6. After recipient of reply from BOD or from audit committee, the cost Auditor examine such reply, forwarded it to central government along with his comments, within 15 days.
7. Fraud reporting by cost auditor involves:-
 - Nature of fraud with description.
 - Approximate amount involved.
 - Parties involved.
 - Remedial actions taken (in case fraud reporting to BOD).

All the above four disclosure shall also be disclosed in board's report (BOD Report).

8. If a cost auditor doesn't comply with the provisions of fraud reporting the pay penalties as follow:-
 - Rs 5lakhs in case of listed company.
 - Rs 11 lakhs in case of other companies.

Set 447 : Punishment for fraud for cost auditor:-

A. Amount of fraud is ₹10 lakh or 1% of turnover of the company, whichever is lower punishments are:-

- Minimum imprisonment is 6 months.
- Maximum imprisonment if 10 years.
- Minimum fine shall be 100% of amount of fraud.
- Maximum fine shall be thrice of amount of fraud.

B. In other cases, punishments are:-

- Maximum imprisonment is 5 years.
- Maximum fine shall be ₹50 lakhs.

FRAUD means:-

- 1) Omission, concealment of any fact.
- 2) Abuse of position
- 3) Intent to deceive someone.
- 4) Intent or do injured of company, shareholders, creditors or of any other.
- 5) Wrongful gain or loss for which person is not legally entitled.

-Sec 448 : Punishment for false statement:-

All the provisions of punishment are imposable u/s 447.

Penal provisions for professional misconduct:-

A. For schedule I :-

- Give warning to the members.
- Remove the name of members for 3 month.
- Fine up to 100,000.

B. For schedule II:-

- Give warning to the members.
- Remove permanently the name of the member.
- Fine up to ₹500,000

C. Section 24 of CWA Act, 1959, penalty are so follows:-

- On first offence, fine of up to ₹1000.
- On subsequent offence, fine of up to ₹5000 or imprisonment up to 6 months or both.

And such offence are as follows:-

- Act as a member, but not a member of institute.
- Use designation of cost accountant but not the member of institute.
- Doing practice as a cost accountant but not have a valid cop.

D. Sec 25 of CWA Act, penalty are as follows:-

- On first offence, fine up to ₹ 1000.
- On subsequent offence, fine up to ₹ 5000 or imprisonment of up to 6 months or both.

And such offence are as follows:-

- Seek to regulate in any manner whatsoever the profession of cost accountants.
- Use a name or common seal identical to the institute.
- Award any degree, diploma or certificate of any qualification or competence in cost accountancy similar to that of a member of institute.

E. Sec 26 of CWA Act, 1959 penalty are as follow:-

- On first offence, fine up to ₹1000.
- On second offence, fine up to ₹ 5000.

Offence is no company can do particle as a cost accountant.

F. Sec 27 of CWA Act, 1959, penalty are a s follows:-

- On first offence, Min fine ₹ 1000 or Max. fine ₹100,000.

- On subsequent offence, min. fine ₹10000 or max. fine ₹200000, imprisonment up to 1 year.

Offence of no person other than a member of the limits shall sign any legal documents on behalf of practicing cost accountant or firm of practicing cost accountant in his or its professional capacity.



CHAPTER - 5

C A S

CAS1 :- CLASSIFICATION OF COST

- ❖ **Abnormal cost:-** Abnormal cost is an unusual cost whose occurrence is usually irregular and unexpected due to some abnormal situations and unexpected due to some abnormal situations arises in the production.

Abnormal cost includes such unavoidable cost which cannot be ignore even the production not takes place.

It also means those annual expenses or mandatory expenses not related to production but have to be paid are known as abnormal cost.

Interruption in the production may be due to strike, lockdown, breakdown of machinery, fire etc. to be and in this interruption situation some cost have to be paid which is known as abnormal cost.

Abnormal cost such as:-

- Indirect expenses,
- Depreciation.
- Fixed expenses not related to production.
- Variable cost payable due to interruption.
- Fixed payable due to interruption.
- And any other proportionate cost payable during interruption.

- ❖ Administrative overheads:- cost of all activities relating to general management and admiration of an entity.

Administrative overheads shall exclude productive o/H marketing overheads, Interest & finance charges.

- ❖ Conversion cost:- conversion cost is the production cost excluding the cost of direct materials.

- ❖ Cost centre:- cost centre is an unit of an entity selected with a view to accumulating all cost under that unit.

Such unit can be a division, a department, a section, a group of plant and machinery, a group of employees or any other combination of several unit.

- ❖ Cost Object:- An activity, contract, cost centre, customer, process, product, project services or any other object for which costs are ascertained.
- ❖ Cost of productions:- Cost of production of a product or a service consist of following items:-

Cost of material consumed.

Direct employee cost.

Direct expenses.

Production overhead.

Quality control cost.

Packing cost.

Research and development cost.

Administrative overhead relating to production.

Further adjustment for stock of WIP finished goods, recoveries for sales of scrap, wastage shall be made.

- ❖ Cost unit:- Cost unit is form of measurement of volume of production of a production / service.
Such as power - MW (megawatt)
Cement - MT (metric tonne)

- ❖ Basis of classification of cost:-

1) By nature of expenses:-

- Material
- Employee
- Other expenses (direct)

2) By nature, traceability to a cost object:-

- Direct expenses.
- Indirect expenses.

3) By functions / activities:-

- Production
- Administration
- Selling
- Distribution
- Research & development.

4) By behaviour:-

- Fixed
- Variable
- Semi-variable

5) By nature of production process:-

- Batch cost
- Process cost
- Operating cost
- Contract cost
- Joint cost

❖ Presentation and Disclosure under CAS-1:-

- i. Classification of cost should be done on the basis of relevant classification.
- ii. Classification of cost item should be followed consistently from period to period.
- iii. A change in classification of cost should be made only if it is required by law or for compliance with CAS.
- iv. Any change in Classification of cost which has a material effect on the cost of the product should be disclosed in the cost statements.

CAS2 :- CAPACITY DETERMINATION

CAS2 deals with the principle and methods of classification and determination of capacity of an entity for ascertainment of the cost of product or of service.

➤ Needs for capacity determination:-

- i. To identify capacity of each deployed facilities and identify bottlenecks.
- ii. To evaluate potential for future expansions, understanding the scope and effort towards de-bottlenecking and balancing of surplus capacities.
- iii. Internal management for planning, scheduling of production and ,monitoring during implementation of the planned programme.

➤ Reporting of capacity in form CRA-3 (cost audit report):-

A. Under part B of CRA-3 for manufacturing sector:-

- i. Installed capacity.
- ii. Capacity enhanced during the year, if any.
- iii. Capacity available through learning arrangement, if any.
- iv. Capacity available through loan licensed/ third party.
- v. Total capacity in aggregate.

B. Under part C of CRA-3 for service sector:-

- i. Installed capacity.
- ii. Capacity enhanced during the year, if any.
- iii. Total capacity in aggregate.

- Installed capacity:- It is the maximum capacity of producing goods or providing services, determine either based on technical specification of the facility or through a technical evaluation.
- Normal Capacity:- It is the production amount achieved or achievable on an average over a period or seasons under normal circumstances after taking into account the loss of capacity resulting from planned maintenance.
Normal capacity is also known as practical or achievable capacity.
- Determine of installed capacity:- Installed capacity is the maximum productive capacity of a plant taking into account the following 5 factors:-
 - Manufactures technical specifications or estimates by experts.
 - Capacities of individual or interrelated productive centres.
 - Operational constraints / capacity of critical machine.
 - Number of shifts.
 - Technical evaluation.
- Determination of Normal capacity:- Normal capacity should be determined after adjustment of the following with the installed capacity:-
 - 1) Holidays , normal shut down days and normal idle time.
 - 2) Normal time loss in batch change over preventive maintenance, normal break down of machines, repairs etc.
- Determination of Idle capacities and utilisation ratios:-
 - 1) Idle capacity = Installed capacity - Utilisation capacity.
 - 2) Normal idle = Installed capacity - practical capacity.
 - 3) Abnormal/ idle capacity = Practical capacity - (higher of normal or actual capacities)
 - 4) Actual capacity utilisation = $\frac{\text{Actual capacity}}{\text{Installed capacity}} \times 100$
 - 5) Idle capacity utilisation = $\frac{\text{Idle capacity}}{\text{Installed capacity}} \times 100$
 - 6) Normal idle capacity Utilisation = $\frac{\text{Normal idle capacity}}{\text{Installed capacity}} \times 100$
 - 7) Abnormal idle capacity utilisation = $\frac{\text{abnormal idle capacity}}{\text{Installed capacity}} \times 100$

Where,

- Installed capacity = maximum productive capacity of a plant.
- Practical capacity = reduction in install capacity due to unavoidable reason / Factor of internal causes.
- Normal capacity = reduction in practical capacity due to unavoidable reason / factor of external causes.
- Actual capacity = reduction in normal capacity due to any other factors / reasons.

➤ Determine of idle capacities under revised CAS-2:-

- 1) Idle capacity = installed capacity - actual capacity.
- 2) Normal idle capacity = Installed capacity - Normal capacity.
- 3) Abnormal idle capacity = normal capacity - Actual capacity.

Where,

- Installed capacity = maximum productive capacity of a plant.
 - Normal capacity = reduction production in installed capacity due to normal reason / factors internally.
 - Actual capacity = reduction in normal capacity due to abnormal or other reason / factors.
- Disclosures to be required under CAS-2 :-
- a) Basis of calculating capacity.
 - b) Any changes in installed and normal capacity from period with reasons.
 - c) Capacity enhanced through outsourcing should be disclosed.
 - d) Capacity in terms of self-productions.
 - e) Reasons for low capacity utilization.
 - f) Abnormal cost due to under utilization of capacity.

CAS 3 : On productions and operations overheads:-

CAS3 deals with the principles and methods of calculation, measurement and assignment of production and operation overheads.

- ❖ Definition of overheads:- Overheads companies of indirect materials, indirect employees, and indirect expenses which are not directly identifiable or not directly allocate to a cost object.
- ❖ Classification of overhead are as under:-
 - Production overhead
 - Administrative overhead.
 - Selling overhead.

- Distribution overhead.
- Fixed, variable and semi variable overhead.

❖ Exclusive from overhead are as under:-

- Overheads incurred due to some abnormal situations because its charged to costing profit & loss account.
- Overheads not related to business activities like donations, loss and other financial charges.
- Foreign exchanges Fluctuation losses.

❖ Measurement principles for overheads:-

- a) Any abnormal cost where it is material and quantifiable shall not form part of the productions o/H.
- b) Any Imputed cost (non cash expenses or national cost) shall not from part of the production or operations o/H, expect depreciation.
- c) Any overhead variances due to abnormal reasons shall not form part of the production or operations o/H. but variances due to normal reasons shall be considered,
- d) Any subsidy , grant, incentive or any similar amount received with respect to production or operations overhead shall be considered.
- e) Any fines, penalties, damages or any levy paid or payable to statutory authorities or to other third parties shall not form of the production or operations overhead.
- f) Any credits or recoveries relating to production or operation overheads shall be deducted from the cost.
- g) Any change in the cost accounting policies related to production or operation overhead shall be made if required by law for compliance with CAS.

❖ Absorption of production or operations overheads:-

- a. The variable production or operations overheads shall be absorbed to products services based on actual production.
- b. The fixed production or operations overheads shall be absorbed based on the normal capacity.

❖ Presentation under CAS 3 :-

- 1) Production or operations overloads shall be presented as separate cost head.
- 2) If materials & necessary, element wise and behaviour wise details of the production or operation o/H shall be presented.
- 3) Any under or over absorption of production or operation overhead shall be presented in the reconciliation statement.

❖ Disclosure under CAS 3:-

- a. This basis of assignment of production or operation overhead to the cost object.
- b. Production or operation overhead incurred in foreign exchange.
- c. Production or operation overhead incurred relating to resource received from or supplied to related parties.
- d. Any subsidy, grant, incentive etc. received or receivable which get reduced from production or operations o/H.
- e. Any abnormal cost not foreign part of production or operation overhead.
- f. Any under absorbed production or operation overheads.

CAS 4 : Cost of production / Acquisition / supply of goods or provision of services.

CAS 4 deals with the determination of cost of production or Acquisition or supply of goods or provision of services.

This standard deals with the principle with the principles and methods of classification, measurement and assignment for the determination of cost production or Acquisition or Acquisition or supply of goods or provision of derbies as required under the provisions of GST act, 2017

As per (GST act, 2017) value of supply of goods or services are determined as follows:-

- Rule 27, where the supply of goods or services is for a consideration which is not wholly in money then the value of supply shall be open market value.
- Rule 28, value of the supply of goods or services b/w distinct or related persons (except agent),

Then the value of supply shall be open market value. But if the recipient wants to do further supply then the value of supply shall be 90% of price charged from its customer.

- Rule 29, value of the supply of goods or services b/w principal and agent. Then the value of supply shall be open market value. but if the agent want to do further supply then the value of supply shall be 90% of price charged from its customer.
- Rule 30, the value of supply shall be 110% of the cost of production or the acquisition of such goods or the cost of provision of such services.

- Scope of CAS4 are as follows:-
 - Determine of cost of production of goods.
 - Determine of cost of Acquisition of goods.
 - Determine of cost of supply of goods.
 - Determine of cost of supply of services.
 - Determine of value of supply of goods are services as per open market.
- Cost of production of goods consist following elements:-
 - Material consumed
 - Direct wages and salaries.
 - Direct expenses.
 - Works overheads.
 - quality control costs.
 - Research and development cost.
 - Packing costs.
 - Administrative overheads related to production.
- Cost of purchase / Acquisition of goods consist following elements:-
 - Purchase price.
 - Import duties and other taxes (net of trade discounts, rebate, taxes and duties).
 - Transport, handling charges.
 - Other costs directly attributes to the acquisition of goods and services.
- Cost of measurement of cost under CAS4 :-
 - a) Cost of production for Acquisition of gods or provision of service shall be measured for each type of goods or services separately.
 - b) Cost of normal scrap / defectives shall be included.
 - c) Realized or realizable value of scrap or of waste shall be deducted or its reprocessing cost if reprocess it.
 - d) Cost of abnormal scrap / waste not be considered, because it charged to costing profit & loss account.
 - e) Cost of packing shall be included.
 - f) High value spare shall be recognised as PPE and depreciated accordingly.
 - g) Depreciation of an asset begins when it is available for use.
 - h) One time payment for Royalty or technical know how shall be amortised on the basis of estimated output or benefit.
 - i) Royalty paid for use of asset or far transfer of technology shall be included but royalty paid for use of brand shall not be included.
 - j) In-house quality cost incurred shall be included and the cost of resources procured from outside shall be determined at invoice value or at agreed price.

- k) Production or operation overheads representing procurement of resources shall be determined at invoice value or at agreed price.
- l) Any abnormal cost, where, it is material and quantifiable shall not be considered and charged to costing profit & loss account.
- m) Interest and finance costs shall not be considered.
- n) Any impairment loss or imputed cost shall not be considered.
- o) Any inputs received from recipient of goods or services as free or at concessional rate shall be considered.
- p) Cost of any free tools, patterns, dies, drawings, blue prints, technical maps, charts, design etc shall be amortised.
- q) Cost of rework, reconditioning, adjustments for WIP, recoveries from sales of scrap & wastages shall be considered.
- r) Any subsidy, grant or incentive received or receivable shall be deducted.
- s) Fines, penalties, damages, demerger charges etc paid to statutory authorities shall not be included.
- t) Any loss due to foreign exchange rate difference shall not be considered.
- u) Any credits recovery received shall be deducted.
- v) Opening and closing WIP also be objected.

➤ Assignment of cost under CAS4:-

- Any abnormal and non-recurring costs, abnormally low plant utilisation, abnormal rejections, accidents, strikes, fires, unexpected court orders etc. shall be ignored.
- The cost which can be traced directly to each type of goods or services shall be directly assigned, and which are not traceable then assigned on following basis:-
 - Cause and effect:- cause is the process or operation or activity , effect is the insurance of cost.
 - On the basis of benefit received
- The variable prod/operations overheads shall be absorbed based on actual production.
- The fixed or operation or production overhead shall be absorbed on the basic of normal capacity or actual capacity whichever is higher.
- In case joint products are produced, joint cost incurred up to the split off point are proportionality apportioned on the desire basic of company.
- In case by-products are produced, the NRV of by products is credited (reduced) to the manufacturing cost of main product.
- Any miscellaneous income relating to production or operations shall be adjusted such as sale of empty containers.

➤ Presentation under CAS4 :- cost statement should be prepared as per the applicable format given in the appendix to this standard and such appendix are so follows:-

- Appendix 1 :- statement of cost of production of the taxable goods.
- Appendix 2 :- statements of cost of provisions / supply of the taxable services.
- Appendix 3:- Statement of cost Acquisition of taxable goods.
- Appendix 4 :- statement of open market value.

The cost statements are credited by the cost accountant in practice, which enable the business entity to determine value as taxable goods or services at that time of supply and issuance of tax invoice.

Such certified cost statements shall be presented with the following periodicity:-

- On six month basis, if turnover in the preceding year of a composition dealer under GST did not exceeded limit of composite scheme.
- On quarterly basis, if turnover in the preceding year of a composition dealer under GST exceeds limit of composition scheme.
- On Annual basis, if GST audit is required i.e. on or before 31 December of next F.Y

➤ Disclosures under CAS4 are as follows:-

- a. Disclosure shall be made only where it is necessary, significant and Quantifiable.
- b. If there is any change in cost accounting policies, principles and practise, same shall be disclosed.
- c. If opening WIP and closing WIP are not ready for certification, same shall be disclosed.
- d. Any other disclosure as any be fit by a practicing cost accountant during cost audit.

CHAPTER - 6

OVERVIEW OF COST AUDITING STANDARDS

INTRODUCTION:-

- 1) The companies (cost records and audit) rules 2014 were notified by the ministry of corporate affairs, government of India in exercise of the powers v/s 148 of companies Act, 2013
- 2) Subsection (3) of section 148 prescribe that the auditor shall follow the cost auditing standards during performing the cost audit.
- 3) Cost auditing standards are issued by the "institute of cost accountants of India" under the cost and works accountants act, 1959 with the approval of central government.
- 4) Following are the cost auditing standards:-
 - Cost auditing standard -101 on planning on audit of cost statement.
 - Cost auditing standard -102 on cost audit documentation.
 - Cost auditing standard - 103 on overall objectives of the independent cost auditor.
 - Cost auditing standard - 1-4 on knowledge of business its processes on the business.

Cost auditing standard -101 on planning an audit of cost statements.

- Planning on audit of cost statements, records and other related documents is considered necessary to ensure achievement of audit objective with available resources and securing coordination with the auditee on audit work.
- This standard is effective for audit on or after September 11, 2015.
- This standard deals with auditors' responsibilities to plan on audit of cost statements, records and other related documents.
- Prior to entering the planning phase, the cost auditor shall ensure that:-
 - a) The appointment as cost auditor is proper, he had received the letter of appointment and legal formalities regarding his appointment have been fulfilled.
 - b) The ethical requirements as per the regulations continue to be satisfied.
 - c) On understanding of the terms of reference including the units to be covered, products or services to be covered and scope of coverage.

- The audit partner and other key members of an audit team shall be involved in planning the audit.
- The cost auditor shall formulate an overall audit strategy that sets the scope, timing and direction of the Audit.
- Following are the relevant factors required for overall audit strategy:-
 - a) Results of preliminary activities.
 - b) Knowledge from previous audits and other engagements with the auditee.
 - c) Knowledge of business.
 - d) Nature and scope of the audit.
 - e) Statutory deadlines and reporting format.
 - f) Nature, timing and extent of resource required for the audit.

Cost Auditing standard - 102 on cost audit documentation:-

1. The purpose of this standard is to provide guidance to the members in preparation of audit documentation in the context of this audit of cost statements, records and other related documents.
2. Nature and purpose of cost audit documentation are as follows:-
 - a) Evidence of the cost auditor's basis for a conclusion about the achievement of the overall objectives of the cost auditor.
 - b) Evidence that the cost audit was planned and performed in accordance with the cost auditing standards and applicable legal and regulatory requirements.
 - c) Assisting the audit team to plan and perform the cost audit.
 - d) Assisting members of the audit team responsible for supervisions to direct and supervise the cost audit work, and to discharge their review responsibilities.
 - e) Enabling the audit team to be accountable for its work.
3. Objectives of cost audit documentation are as follows:-
 - A sufficient and appropriate record on the basis of cost audit report shall be maintained.
 - Provide / facilitate evidence, that the audit was planned and performed in accordance with cost auditing standards and all applicable legal and regulatory requirements.
4. The cost auditor shall record all the discussion with client personnel and with outsiders.
5. The cost auditor shall record all the audit evidence, results of audit performed.
6. The cost auditor shall maintain all the new or additional audit procedure after the date of cost audit report.

7. The cost auditor shall record nature, timing, scope of audit report.
8. The cost auditor shall prepare audit documentation on a timely basis.
9. The cost auditor shall assemble the audit documentation in an audit file.
10. Cost auditing standard 102, is also effective for auditor on or after September 11,2015.]

Cost auditing standard overall objectives of the independent cost auditor and the conduct of an audit in accordance with cost auditing standards - 103

1. This standard deals with the overall objectives of the independent cost auditors, the nature and scope of a cost audit.
2. Cost auditing standard -103 explain the requirements establishing the general responsibilities of the independent auditor.
3. Objectives of the cost auditing standards - 103 are as follows:-
 - To obtain reasonable assurance about whether the cost statements are free material misstatement.
 - To express an opinion on whether the cost statements represent a true and fair view of the cost of production cost of sales and margin of products covered by the cost audit.
 - Where reasonable assurance cannot be obtained then the cost auditor should qualify the opinion.
 - The cost auditors objective may extend to making observation and suggestions where required by applicable regulations.
4. The cost auditor shall comply with the all relevant ethical requirements in respect of cost audit engagements.
5. The cost auditor shall comply with each of the relevant cost auditing standard applicable in a proper manner.
6. The cost auditor shall plan and perform an audit an attitude of professional suspicion.
7. The cost auditor shall obtain sufficient appropriate audit evidence to reduce audit risk.
8. The cost auditor shall determine whether the cost reporting framework followed by management in preparing cost statements is in line with the companies act, 2013.
9. This standard is effective for auditor on or after September 11, 2015.

Cost auditing standard -104 on knowledge of business, its process and the business environment:-

1. The cost auditor should have the knowledge of the clients business to enable him to understand the process and express his opinion on the cost statements.
2. The cost auditors level of knowledge for a cost audit engagement should include a general knowledge of the economy and the industry within which the entity operates, and a more particular knowledge of how the entity operates.
3. The cost auditor should obtain an understanding of the following things:-
 - The nature of the entity (including its operations covering business process, major inputs, joint and by products, wastage , major outputs etc.)
 - The entity's ownership and governance structure.
 - Relevant industry, regulatory , and other external factor including the applicable cost and financial reporting frame work.
 - The entity's selection and application of cost accounting policies.
4. Following are the understanding related to entity's internal control:-
 - Control environmental:-The cost auditor shall evaluate whether management has created and maintained a culture of honesty and ethical behaviour.
 - Entity's Risk assessment process:- The cost auditor shall obtain an understanding of whether the entity has a process for:-
 - Identifying business risks relevant to cost reporting objectiveness.
 - Assessing the likelihood of their occurrence.
 - Deciding about actions to address those risks.
 - Cost information system/management information system:- The cost auditor shall obtain an understanding of the information system including MIS.
 - Control activities :- The cost auditor shall obtain an understanding of the control activities, relevant to audit.
 - Monitoring of controls: The auditor shall obtain an understanding of the major activities, that the entity uses to monitor internal control over reporting.
5. Following are the understanding related to It (information technology) environment and control:-
 - It architecture, system and programmes in use in the entity.
 - Controls on access to data.
 - Controls on charges to data in master files, system or programmes.

➤ Integrity of information and security of the data.

6. The cost auditor shall identify and assess the risks of material misstatement at the cost statement level.

7. This standard is effective for auditors on or after September 11, 2015.



CHAPTER - 7

FILING OF COST AUDIT REPORT TO MCA IN XBRL FROMAT

INTRODUCTION:-

- XBRL stands for "extensible business reporting language".
 - ABRL is the open international standard for digital business reporting, managed by a global not for profit purpose called XSRL international.
 - Millions of XBRL documents are created every year.
 - The change from paper, PDF and HTML based reports to XBRL is like change film photography to digital photographer or from paper maps to digital maps.
 - Every company covered under the cost records and audit rules, shall within 30 days from the date of receipt of cost audit report from the cost auditor furnish the same cost audit report along with all explanation on the cost auditors to the central government in form CGA-4
 - Form CRA-4 file online to the MCA portal along with fees in XBRL format.
- ❖ Potential uses of XBRL:- XBRL has applications in the following areas:-
- Reporting for internal and external purpose by an entity involving finance and cost data/ information.
 - Business reporting to all types of regulator including tax authorities, central banks and governments.
 - Filing of loan reports and its applications.
 - Exchange of information b/w government department.
- ❖ Benefit from using XBRL:-
- XBRL has bright future ahead of it, all types of organisation can make use of XBRL to automate their process of data collection and distribution to various stakeholders.
 - It helps in saving costs and improving the efficiency in managing business information.
 - XBRL being extensible and flexible which can be adopted to a wide variety of requirements.
 - All stakeholders whether they are prepares, transmitters or users of business data in the financial information supply of business data in the financial information supply chain benefit from the use of XBRL to all of them.

❖ Benefit of having cost related data in XBRL format:-

- Government and regulators require cost data of different sectors for policy making.
- The availability of cost data in XBRL format enables informed decision making and for sectoral studies.
- With full adoption of XBRL, companies would be able to integrate its financial and cost data cross its operational area and exercise better control on its activities.

❖ Costing Taxonomy:-

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

❖ How can the cost audit report and compliance report is converted into EBRL format:-

XBRL is an open source technology any of the following methods can be adopted to create the documents which required for filling of the respective reports:-

- XBRL enabled software packages developed by different software vender which support the creation of cost reports in XBRL format and which can be used to create the necessary document.
- Various elements of cost audit report and compliance reporting can be design into XBRL tags of the costing taxonomy.
- Different third-party packages can be integrated into the existing accounting system to generate XBRL cost statements.
- There are various web-based applications available that take input reports in various formats like MS Excel , word, PDF, etc and transform them into XBRL format.

❖ What process is to be followed to file the reports in XBRL format:-

- Mapping the individual cost elements of the company to the elements of the costing taxonomy.
- Populating the relevant data in the filing tool i.e., software.
- Creating instance documents.
- Validating the instance document with the validation tool of MCA.
- Use available to convert the instance document to a human readable format and check correctness of data.
- Attaching the instance document to the e-form and filling on MCA patrol.

CHAPTER - 8

BASICS OF MANAGEMENT AUDIT

❖ Definition of management audit:-

Management audit is the process of judging or analysing the performance of directors, managers on other words, analysing the performance of the management. It attempts to look into all aspects of the management performance.

❖ How is management different from Administration:-

Administration is concerned with the structure of the organisation and the mechanism of its operation, whereas.

Management relates to the leadership and direction of the people, the way in which they are controlled to exercise their functions within the administration frame work.

❖ Agency theory of management:-

- It is a relationship b/w two parties in which one is agent and another one is principal in a day-today transaction.
- The principle have hired the agent to perform a specific services on their behalf.
- Most commonly , that relationship is the one b/w shareholders & stakeholders as principle and b/w company executives as an agent.
- Management audit extends to examination of accountability b/w management and other at large.
- The examination of accountability and ensuring shareholder's welfare and other's executives welfare becomes important.

❖ Objectives and uses of management audit:-

- Assessment the management performance at all level of management.
- Highlight the decisions or activities that are not in the favour with organizational objectives.
- Ascertain such objectives are properly understand at the level.
- Evaluate plans which are projected to meet objectives.
- Reviewing the company's organization structure.
- To ensure optimum utilization of all the resource employed.
- To suggest improvement in methods of operation.
- To anticipate problems and suggest remedies to solve them in time.

❖ Needs and benefits for management audit:-

- It helps management in framing basic policies for the organisation and to define objectives.
- It helps in setting up an organisational framework to implement the plans.
- It assists in designing systems and procedures for smooth operations of the organisation.
- It helps in designing and reviewing management information system (MIS) of the decision making to help in coordination, motivation, and control of the operations.
- It assists in analysing SWOT (strength, weakness, opportunities, threats) of the organisation more strongly.
- It can help in analysing social-cost benefit for public projects like dams, power houses, national highway etc.

❖ Scope of management audit:- Management audit is wider in scope and covers every activity of the organisation.

Scope of management audit are as follows:-

- Efficient utilisation of resources of the organisation.
- Rate of return of investor's capital, whether it is poor, adequate or above average.
- Relationship of the business with its own shareholders and with investing general public.
- Suitability of the plans, activities and decisions of the organisation with its desired objectives and aims.
- Reviewing current image of the organisation among customers, general public.
- Ensuring aims, and effectiveness of management at its various levels such as Top level, middle level, low level.

❖ Qualities of management auditor are:-

- Ability to understand business problems.
- Ability to understand purpose, objectives, Motive of an organisation.
- Ability to assist the programme of management.
- Have to knowledge about the principle of delegation of authority.
- Ability to understand different internal control devices, how charts, flow of work etc.
- General understanding of all economic and commercial legislations, like company law, custom law, Tax laws, etc

- Ability to prepare reports for various level of management.
- ❖ Functions of management auditor:-
 - Marketing including selling and distribution.
 - Manufacturing or servicing including maintenance of supply chain, maintenance of machinery & equipment.
 - Human resource management from selection to recruitment them training, motivating, retaining etc.
 - Finance including maintenance of accounts and providing accounting information to guide the management about its performance and position.
 - Research and development including application of basic reassures.
 - Maintaining personal policies and industrial relatives.
- ❖ Source of information to the management auditors:-
 - a) Management survey:- This the best way to identify possible controllable weakness.
 - b) Management reports:- The auditors review of management and internal reports may be used to obtain information on progress, status or accomplishment of work.
 - c) Internal audit or inspect reports:- Just like management reports, internal audit or inspection reports can also be a valuable source of information on problem areas.
 - d) Physical Inspection:- Physical inspection of the organisation activities and resources by the auditor can eb a useful way of identifying possible inefficiency.
 - e) Discussion with the officials and employees:- The management auditor can obtain valuable information on problems areas through discussions with responsible officials in the organisation and with another employee.
 - f) Testing procedures and practise:- Test checking of the practice and procedures, may indicated problem areas on weakness.
And, thereafter documents report of all the above source discussed shall become "evidence of management audit" performed. .
- ❖ Techniques of management audit:-
 - 1) Accounting or economic techniques:- It includes:-
 - Breakeven analysis.
 - Budgetary control.
 - Coast management techniques.
 - Discount cash flow and net present value methods.
 - Standard costing and marginal costing.

- ABC analysis.
- 2) Scientific techniques :It includes:-
 - Using computer models to take decision or to decide material mix / product mix.
 - Network analysis.
 - Linear programming.
- 3) Statically techniques:- It includes:-
 - Activity sampling.
 - Simulation technique.
 - Interfirm comparison.
- 4) Personal techniques:- It includes;-
 - Attitude
 - Man-machine relationships.
 - Training methods.
 - Profitability and productivity measurements.
- 5) General techniques:- It includes;-
 - Transfer pricing
 - Corporate planning
 - Brain storming.
 - Information theory.
- ❖ Characteristic of a good management audit report:-
 - Relevance:- The auditors report should be relevant to the area for which the audit has been conducted.
 - Comprehensive :- The audit report should cover all the aspects of the audited areas.
 - Brevity:- The audit report should be brief for explanation and for understanding
 - Timelines:- The audit report should be issued in a timely manner, so that suitable rectification. May be taken on time.
 - Motivating:- The management auditor should use positive wordings in the audit report.
 - Formatting & presentation:- The audit report must be drafted in a good format for the report.
- ❖ Management Audit programme (MAP):-
 Management audit programme is an essential facility for conducting management audit.
 It is a plan of action drawn in advance for taking up the audit and to help the auditor to cover the entire are of his function

Following are the contents of MAP:-

- 1) Review of the organisation objectives and plan .
- 2) Study the management policies and parties.
- 3) A critical review of the organisation structure.
- 4) Study of the system and procedures.
- 5) Evaluation of operations.
- 6) Study of the efficiency of use physical resources available.
- 7) Exercise of proper management control.
- 8) Regularity checking on adherence to the all statutory obligation applicable.

❖ Difference b/w management audit, Internal audit, financial / cost audit;-

Bases	Management audit	Internal audit	Financial cost audit
Attitude	Friendly and guider	Policeman or judge	Watch dog
Agency	Outside team.	Internal or external	Specially designated person.
Force	Voluntary.	Statutory in some cases.	Statutory or voluntary.
Areas	Complete management	Main parts	Specific objective.
Period covered	Past, present and future	Past and present	Mainly past.

CHAPTER - 9

INTERNAL AUDIT

Internal audit is an independent appraisal activity within an organisation for the review of operation as a service to management.

It improves managerial control by measuring and evaluating the effectiveness of other controls and by maintaining a vigilant watch over the risks.

- Necessity of internal audit:- The necessity of internal audit are as follows:-
- a) Internal audit assist management to improve internal controls by identifying weakness in system and provides on opportunity to correct those weakness.
 - b) It helps to detect errors and frauds and provides suggestions to improve them in systems and provides an opportunity to correct those weakness.
 - c) It detects the misuse of resources in time which helps to reduce unnecessary expenses.
 - d) It increases the morale of honest staff because evaluation of performance of any staffs will be made at any time.
 - e) Internal audit checks the books of accounts, detections of errors and frauds and help in the corrections.
 - f) It helps capacity building for organizational effectiveness.

❖ Internal auditing under companies act, 2013

List of compulsory requirements for appointment of internal auditor in listed and specified companies:-

- Every listed company.
- Every unlisted company having paid up capital of ₹50Cr or more during preceding F.Y,
- Every unlisted public / private company having turnover of ₹200Cr or more during preceding F.Y
- Every unlisted public/ private company having outstanding loans or borrowings from banks or public financial institutions exceeding ₹100Cr or more at any point of time during the preceding F.Y.
- Every unlisted public company which has accepted deposits of ₹25Cr or more at any point of time during the 6 months.

If an existing company fulfils any of the above conditions than such company shall appoint an internal auditor within 6 months.

- ❖ Eligibility for appointment as internal auditor:- The internal auditor shall either be a cost Accountant or a chartered accounted or such other professional as may be decided by the board of directors.
- ❖ Requirements for filling of form MGT-14 with the ROC on appointment of internal auditor:- The company is required to file form MGT-14 with the ROC within 30 days from the date of passing of boards resolution because appointment of internal auditor take place after passing board resolution or upon the decision of audit committee.

Important Note:- statutory auditor cannot be an internal auditor of the same company.

- ❖ Punishment for contravention of any provisions:-
 - The company and every officer of the company who is in default shall be punishable with affine up to ₹1000.
 - In case of subsequent offence, there shall be additional fine of ₹100per day.
- ❖ Areas/ scope of internal audit in a company:-
 - Independent review and appraisal of control systems across the organization (both financially & operationally).
 - Checking all the relevant compliance, procedures, regulations and legislations.
 - Facilitating a good practice in management of risks. This requires systems for ascertaining, measuring, managing and eliminate the risk, if possible.
 - Achieve savings by activities waste, efficiency and duplicate of effort across the organisation.
 - Structuring programmes and activities such that the company's assets are safeguarded and there are internal check system which minimise the possibility for reducing guard and provide early warning signals warning for identifying fraud.
- ❖ Preparation for audit:-

Following steps shall be followed for performance of any audit:-

 - a) Defining the scope of the audit work i.e. preparation of the audit engagement letter.
 - b) Obtaining the knowledge of the clients business and formulating the audit programme.
 - c) Evaluation of the accounting and internal control system existing in the audited enterprise.
 - d) Determine the nature timing and extent of audit procedures keeping in mins the audit risk and materiality involved.

- e) Adequate documentation is also necessary i.e., preparation of audit note book and work papers.
- f) Formulation of opinion about the financial statements.
- g) Issuance of audit report.

❖ Techniques to be used by audit to collect the necessary evidence:- Such technique used by auditor are so follows:-

- Vouching.
- Confirmation.
- Physical examination and verification.
- 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 audit 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:-

- a) It serves as a ready check list of audit procedures to be performed.
- b) The audit work can be properly allocated to the audit assistants or to the articles clerks.
- c) The audit may easily know the extend of work done at any point of time.
- d) A uniformity of the work can be attained as the same programme would be followed from time to time.
- e) It is a useful basis for planning the programme for the following year.
- f) It may be used as evidence by the auditor in the event when any charge is brought against him,
He can prove that there is no negligence on his part and he exercised reasonable care and skill while performing the task.

Disadvantage of audit programme:-

- The auditors task becomes mechanical and the auditors may lose interest and imitative.
- Drawing up of an audit programme may be unassay for a small concern.
- Though audit programme helps infixing responsibilities but inefficient 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.

An example of audit programme:-

M/S ARIHANT TRADING PRIVATE LIMITES Audit programme for the month/ F.Y			
Type of audit staff involved	Statutory audit	Tax audit	Cost audit etc
Particular obtained management confirmation letter.	Remarks	Time taken	Signature.
Financial statements. Cost statements Annexure. Cash flow statements, etc.			

❖ Continues audit And final audit:-

Continues audit:- Continues audit involves the details examination of all the transactions by the audition continuously through out the year at regular intervals whether monthly, quarterly, half-yearly.

A continuous audit is one which is commenced and carried on before the close of the F.Y to which it relate.

It Involves the constant engagement of auditors staff at the client office through the period under review.

Continuous audit is suitable in cases where the final accounts are desired to be presented soon after the close of the F.Y. or if there is great volume of transaction or if the system of internal check is weak.

Final Audit:- a final audit is also called as completed audit are periodical audit. Final audit is done after the close of the F.Y .i.e. after the books of accounts have been closed.

In this type of audit, the client gives the possession of books of accounts to the auditor for audit and routine checking & 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.

The audit working papers for the current year are referred to as the current working papers.

Working that are relevant to more year one audit engagement are often kept separately in a file referred to as permanent working papers.

These working papers serve following three purpose:-

- Aid in planning and performance of the audit.
- Aid in supervision and review of the audit work.
- And these papers serve as an evidence of the audit work performed by the audit to support his opinion.

Former and content of working papers vary from audits to audits, but they depends on following matters:-

- Nature of engagement.
- Nature and complexity of clients business.
- Nature and condition of clients records.
- Form of audit report.
- Supervision of work performed by assistants.
- Degree of reliance of internal control.

❖ **Difference between permanent audit file and current audit file.**

s.no	Permanent audit file	Current audit file.
1	Legal and organizational structure of the entity like MOA and AOA.	It is related to acceptance of annual reappointment.
2	Extracts or copies of legal documents agreements and munities relevant to the audit.	Extracts of important matters in the minutes matters in the minutes of boards meeting and general relevant to the audit.
3	A record if study and evaluation of internal controls.	Copies of management letters.
4	Analysis of significant ratios and trends.	Analysis of transaction and balances.
5	Copies of the audited financial statements of P.Y.	Copies of communication with other auditors, experts and third parties.
6	Notes Regarding significant accounting policies.	It contains audit programme.
7	Significant audit observation of the earlier of P.Y	Conclusions reached on significant aspects of audit.

❖ **Audit note book**:- An audit book is usually a bound book in which a large of matters observed during the Couse of audit are recorded. The audit note book is permanent record of the auditors.

Contents of audit note book are as follows:-

1. Name of the business enterprise.
2. Organisation structure
3. important provisions of MOA and AOA.

4. Communication with previous auditor, if any
5. List of books of accounts maintained by the enterprise.
6. Accounting methods, internal control system. Application laws.
7. Key managerial personnel.
8. Errors and fraud discovered , and other special points.

Specimen of audit note books:-

M/s star private limited audit note book for the F.Y

Voucher No	Account involved	Amount	Remarks (over)	Solution (as per your judgment)
St-31	Books of A/c	₹25000	Cash payment	Disallow
St-45	Depreciable assets	₹5500	Incorrect rate of depreciation	Impose correct rate.
St-51	TDS	₹1000	Not dedicated	Deduct & pay
St-66	PF	₹22000	Not contributed	Contribute & pay.

- ❖ Auditor's engagement letter:- When the Auditors agree with the clients management about the scope terms and conditions of the audit engagement in writing then this written letter / communication is referred to as an engagement letter.

This letter is usually addressed to chairman of the audit committee or to the chair of BOD, with a copy being sent to the audit committee.

- ❖ Example of audit engagement letter:-

To,

M/s XYZ & co

Cost accountant or chartered accountant

Subject: Audit engagement letter related to terms & conditions

Respected sir / Mam,

This representation letter is provided in connection with your audit of the financial statements of ABC private limited for the year ended 31.3.2022 for the purpose of expressing on opinion as to whether to financial statements an opinion as to whether the financial statements give a true and fair view of financial position or not.

Below is the some term and conditions:-

- Objective & scope of the engagement.
- Management's responsibility.
- Restriction on auditor's liability, if any.
- Audit fees payable, etc.

Thanking you

ABC private limited.

Director name _____

PIN _____

Date _____

❖ Role of CMAs in Internal Audit:-

- CMAs hold the expertise to evaluate the operational efficiency, productivity, wastages, losses and inefficiency.
- CMAs have a vital rate of play, as they have an unique blend of cars competencies in accounting, management and strategy.
- CMAs can apply their forward looking insight across the organisation to manage risks, reduce costs and create new opportunities, Preserve & Enhance values.
- The perspective of CMAs has changed in the present era of mergers and acquisition, new product development and also to climate change and sustainability.
- The financial perspective, customer perspective, operational perspective and people perspective, all can be aligned to meet the goal of the business.
- The expectation of the BOD from internal Auditors {CAMs} is now to assist the board in identification, monitoring and management of business risks and also to offer and provide insight, advice and assurance on enterprise risks.
- The reputation CMAs as on internal auditor should also inform to BOD about the tone of the organization culture, ethics, and performance and continuously evaluate the efficiency and effectiveness of operations.
- CMAs should be check compliance with applicable laws and regulations and should authenticate the reliability of financial and management reporting.
- CMAs have the added role of safeguarding the assets of the company.
- They should evaluate performance management and Act as an advisor to the management. The role of effective cost management involves in waste reduction and enhancing productivity and process improvement.

CHAPTER - 10

INTERNAL CONTROL, INTERNAL AUDIT AND OPERATIONAL AUDIT

PART -A

Internal control means identifying and assessing the risk of material misstatement through understanding the entity and its environment.

Internal controls are certain checks and procedures installed by the management to prevent financial fraud or misappropriation of assets.

❖ Objectives of internal control:-

- To safeguards corporate assets.
- To ensure accuracy and reliability of data
- To promote efficiency.
- To measure compliance with corporate policies.
- To measure compliance with regulations.
- To manage the negative events and effects from frauds.

❖ Types of internal control:-

- a) Administrative control: - administrative controls include all types of managerial controls related to the decision making process.
- b) Operational control: - This is exercised through refers primarily the management plans, objectives and producers that are concerned with the safeguarding of assets, prevention and detection of fraud and errors.
- c) Financial and accounting control: - This control refers primarily the management plans, objectives and producers that are concerned with the safeguarding of assets, prevention and detection of fraud and errors.
- d) 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:- Followings are to be considered as structure of internal control:-

- Types of business.
- Magnitude of the business.
- Infrastructure available in the organisation.
- Potentiality of the human resources and their outlook.

❖ Scope of Internal control:-

- Reliability and integrity of financial and operating information:- Internal auditor should review the reliability of financial and operating information and the means used to identify, measures, classify & report such information.
- Compliance with laws, policies, plans, procedures and regulations:- Internal auditor should review the system established to ensure should review the systems established to ensure compliance with those policies, plan and producers, laws and regulations.
- Safe guarding of assets:- Internal auditors should verify the existence of assets and should review the means of safeguarding assets.
- Economic and efficient use of resources: - Internal auditor should ensure the economic and efficient use of resources available.
- Accomplishing of establishing of established objectives and goals for operations: - Internal auditor should review operation or programmes to ascertain whether results are consistent with established objectives and goals.

❖ Limitations of Internal control:-

- A. Costly: - Design and implementation of internal control is a costly affair, cost benefit analysis should be undertaken.
- B. No control for unusual transaction: - Sometimes unusual or mislead transaction takes place and not caught up by the internal auditor.
- C. Human errors: - Human judgment in decision making can be faulty and the breakdowns in internal control which can occur because of human errors.
- D. Collusion among employees: - There may be possibility of loopholes with controls through manipulation with parties outside entity or within the entity's employee.
- E. Abuse of authority:- The possibility that a person responsible for exercising control could abuse that authority.
- F. Inadequate procedure: - There may be possibility that procedures may become inadequate due to the changes in conditions and compliance.
- G. Manipulations by management:- There may be manipulations by management due to misuse of powers and authority.

❖ Evaluation of Internal control: -

- The evaluation of internal controls including internal accounting controls gives an opportunity to the auditor for a clear insight into the operational systems and into an overall view of organisational workings.

- It is because, internal control spot weakness in the systems and procedures regarding financial and operational areas of the business.
- The audit process effectively evaluates the audits existing internal controls through the use of questionnaires and flow employee.
- The audit committee shall have powers to investigate any activity within its terms of references, to seek information from any employee.
- These are prescribed limit for company which have to establish an audit committee to perform their prescribed function related to audits.

Prescribe limit for companies to establish on audit committee are as follows: -

- ❖ All public companies with a paid up capital of ₹10 cores or more;
- ❖ All public companies with a turnover of 100 corers or more;
- ❖ All public companies, having in aggregate, outstanding loans or borrowings are debentures or deposits "exceeding" ₹20 corers or more as on the date of last audited financial statements.

Role/ prescribed functions of audit committee are so follows: -

- To evaluate of internal financial controls and risk management systems.
 - To review the performance of statutory & internal auditor and the adequacy of internal control systems.
 - TO reviewing the adequacy of internal audit functions.
 - To discuss all the relevant findings with the internal auditor.
 - To appoint, remove and decide the remuneration of the internal auditor.
 - To discuss the nature & scope of audit with statutory auditors.
- ❖ Internal control and the Auditors : -
- On the basis of Audit work performed, the Auditor may identify deficiencies in internal control, if any.
 - The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.
 - The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis.
 - The Auditor shall include in the written communication of significant deficiencies found in the internal basis.
 - a) A description of the deficiencies and an explanation of their potential effects and
 - b) Sufficient information to enable those charged with governance and management to understand the context of the communication.
 - c) Auditor should given his opinion on the financial statements of company.

❖ Factors for successful internal control: -

- a) Segregation and radiation of duties:- It is very necessary for successful internal control system that no one person handles the complete transaction.
- b) Competence and Integrity of people: - Honest, competent and integrity peoples are necessary for successful implementation of internal control.
- c) Appropriate levels of Authority: - A common error usually made is to grant too much authority within control boundaries. However, controls to be effective require the authority to be granted on a need to have basis only.
- d) Accountability: - The internal controls to be successful presuppose that there is full accountability of all the decisions taken.
- e) Supervision and periodical updating: - It is very necessary for the controls to be adequately supervised and periodically updated in line with the change in the environment for the effective and successful internal control.

Part C operational Audit:-

An operational audit has been defined as an organized search for ways of improving efficiency and effectiveness.

The objective is to assist the organization in performing functions more effectively and economically with focus on the efficiency and effectiveness of operations, it is also stated to be an early warning system for the detection of potentially distractive problems.

Operations audit is a process to determine ways to improve production. It falls into category of a management service by evaluating the four functions of management, namely.

- Planning.
- Organizing.
- Directing.
- Controlling.

Difference between Internal audit and Operational Audit.

s.no	Internal audit	Operational audit
1	compliance objective.	Risk identification, process improvement objective.
2	Focus on financial accounts	Focus on business activity
3	Audit focus	Efficiency and improvement focus.
4	Transaction based	Process based.
5	Policies and procedures focuses.	Risk management focuses

6	Cost centre wise budget monitoring.	Accountability for performance improvement results.
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❖ Internal audit in different sectors:-

1. Audit of Hospitals: - The following points are to be considered necessary for conducting and audit of a hospital: -

- a) Check the letter of appointment to ascertain the scope of responsibilities.
- b) Check the registration including charter or trust deed.
- c) Verify the system of internal check, Internal control.
- d) Verify the entries in the patient's bill register with copies of bill issued. And check them with the period of stay of each patient as recorded in the attendance schedule.
- e) Ascertaining that arrears of dues should be properly carried forward and where these are decreased to be irrecoverable, they should be written off.
- f) Ensuring that interest or dividend income should be recorded as separate in the investment register.
- g) Ensuring that income from donation should not be applied in purpose other than clarity.
- h) Ensuring that there should be clear distinction between the items of capital and revenue nature.
- i) Examine that the appointment of the staff, payments of salaries etc. Are duly authorised.
- j) Physically verify the investments, fixed assets & inventories.
- k) Check that adequate depreciation has been provided on all the depreciable assets.

2. Audit of hotels: - The business of running a hotel is very much different an Industrial unit for manufacturing of products. It is a services oriented industry.

The business is characterized by handling of large amounts of liquid cash, stock of foods, providing a Variety of services and keeping watch on customer to ensure that they do not level hotels without setting the dues.

In view of these, the following matters require special attention by the auditor: -

1) Internal control: - The following matters should be check: -

- Effectiveness of arrangement regarding receipts and distribution of cash.
- Procedures for purchase and stocking of various commodities.
- Procedures regarding billing of the customers in respect of room services. Telephone, laundry etc.
- System regarding recoding and physical custody of edibles, wines, cigarettes, crockery, furniture's, etc.

- Ensure that trading accounts are prepared for each sales and a scrutiny of the percentage of profit should be made.

2. Room sales and cash collection: - verify the following matters: -

- Ensure that price charged from customer should be accurate and matched with actual stay period.
- The total sales reported with the total bills issued at each sales point have to be reconciled.
- There should be adequate policy for cash transactions.
- Billing should be done room-wise; it must be ensured that all customers pay their bills on leaving the hotel or within specified dates.

3. Stock: - The stocks in a hotel are all saleable item like food and beverage therefore, following item may be noted in the regard: -

- All movements and transfer of stocks must be properly documented.
- Areas where stocks are kept must be properly locked and the entire key be retained by the department manager.
- The key should be realised only to trusted personnel.
- The auditor should ensure that all stocks are valued at the year end and auditor should himself present at the yearend physical verification.

4. Fixed assets: - The fixed assets should be properly depreciated, and the fixed assets register should be updated.

5. Casual labour: - In case, the hotels employees a casual labour, the auditor consider whether adequate records have been maintained in this respect and there is no manipulation taking place.

And the wages payment of the casual labour must also be checked thoroughly.

6. Compliance: - The compliance with all statutory provisions and compliance with the foreign exchange regulations must also be verified by the auditor.

It is because hotels offer of conversation of foreign to rupees (due to foreign tourist comes to India).

3. Audit of educational institutions : - Following verification shall be taken: -

- First of all check the registration and trust deed.

- Read through the minutes of the meetings of the managing committee or of governing body.
 - Check names entered in the student's fee registration for each term with the respective class register, showing name of the students on rolls and test check amount of fees charged.
 - Verifying that free studentship and concession have been granted to a student who fulfils eligible criteria.
 - Confirms that fines for late payment or absence etc, have either been collected under proper authority.
 - Verify rental income from landed properly with the rent rolls.
 - Verify government or local quantity grant with the relevant papers of grant.
 - Report any old heavy arrears on account of fees to the managing committee.
 - See that increase in the salaries of the staff have been sanctioned and approved by the committee.
 - Verify the annual statements of accounts of accounts and see that separate statements of accounts have been maintained for game frauds, poor funds, provident funds etc.
4. Audit of Co-Operative societies: - Following matters shall be verified: -
1. Examination of overdue debts: - overdue debts for a period from six months to five years and more than five years will have to be classified and shall have it working capital position.
They will have to be classified as good or bad. The auditor will have to ascertain whether proper provisions for doubtful debts are made and whether it is satisfactory or not.
The percentage of overdue debts to the working capital and loan advanced will have to be compared with last year, so that necessary action shall be taken.
 2. Overdue interest: - Overdue interest should be excluded from interest outstanding and accrued due while calculating profit.
Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue.
 3. Certification of Bad debts: - Bad debts and irrecoverable losses before being written off against bad debts funds, reserve funds etc. Should be certified as bad debts or irrecoverable losses by the auditor.
 4. Valuation of assets and liabilities: - The auditor will have to ascertain existence, ownership and valuation of assets, fixed assets should be valued at cost less adequate provisions for depreciation. The incidental expenses incurred in the acquisition and the installation expenses of assets should be properly capitalised.

5. Adherence to co-operative principles: - the auditor will have to ascertain in general, how to object for which the co-operative organisation is set up, have been achieved in the course of its working while auditing the expenses, the auditor should see that they are economically incurred and there is no wastage of funds.
6. Verification of members register and examination of their pass books: - examination of entries in members pass books regarding the loan given and its repayment, and confirmation of loans balances in person is very much important in a entries in the books of accounts are free from manipulation.
5. Audit of self- Help group: - Self help group (SHG) movement in India has been recognised as an effective for mobilization and empowerment of rural people, particularly poor women and other marginalized groups.
- Background review: - During a back ground review, a preliminary examination of the group level records (included cash book) shall be conducted. The auditor also does a general review of the group level records and member passbook to verify data entries for their accuracy and correct posting.
 - Prepare field balance sheet: - The auditor prepares the field balance sheet for the SHG as on the date of audit based on the SHA's internal records and then verify the correctness of balance sheet items. The primary objective is to ascertain the retained earnings of the SHG.
 - Private meetings with members:- The auditor should conducts private interview with min 25% of total members to triangulate information collected from the background review as well as from the field balance sheet, to ascertain the decision making pattern in the group.
 - Meeting with the SHG Group: - if serious issues were raised during the course of the audit, the auditor will met with the entire group for further discussion.
 - Reporting: - Once the audit is completed then the auditor summaries any weak practise that put savings at risk or make records unreliable and recommends any better methods.
6. Audit of non- governmental organisation (NGOs) : - while planning the audit of a NGO, following matters shall be verify: -
- Knowledge of the NGOs work, its mission and vision areas of operations shall be examined.
 - Reviewing the legal form of the organisation and its MOA, AOA, rules and regulations.
 - Reviewing the NGOs organisation chart, financial and administrative manuals.

- Examination of munitities of the board/ managing committee governing body and of management of the NGO.
- Study the accounting system, procedure, internal controls and internal checks existing for the NGO and verify their applicability.

The audit programme should also include verification of all assets, liabilities, income and expenditure in the following sequential order: -

- Campus fund
 - Reserves
 - Era - marked funds
 - Project balances
 - Loans
 - Fixed assets
 - Investments
 - Cash in hands
 - Bank balance
 - Stock in hand.
 - Programme and project expenses
 - Establishment expenses.
 - Contribution and grants for projects and programmes.
 - Receipts from and fund arising programmes.
 - Membership fees.
 - Subscription.
 - Interest and dividends.
7. Audit of local bodies: - local bodies are institutions of 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 broadly classified into two categories namely: -

- Rural local bodies (panchayat): Which constituent for local planning, development and administration in rural areas.
- Urban local bodies (Municipalities): Which constitute for local planning, development and administration in urban areas.

Following matters shall be verified during an audit: -

1. Budgetary procedure: - The objective of local bodies budgetary procedure are financial accountability, control of expenditure and to ensure that funds are raised and moneys are spent by the executive department in accordance with the rules and regulations and within the limit of sanction and authorisation.

2. **Expenditure control:** - At state and central level, there is a clear demarcation b/w the legislature and executive. In the local body, legislative powers are vested in the council where as executive powers are delegate to the commissioners. All matters of regular revenue and expenditure are generally delegated to the executive wing.
3. **Accounting system:** - municipal accounting system has been conventionally prepared under the cash basis. In recent past, it is being changed to the accrual system of accounting. The accounting system is characterised by: -
 - a) Subsidiary and statistical registers for taxes, assets etc.
 - b) Separate vouchers for each type of transaction.
 - c) Compulsory monthly bank reconciliation.
 - d) Submission of summary reports on periodical basis.

Objectives of audit are: -

- a) To repeat the content and presentation of financial statements are true and fair.
- b) Detection and prevention of error, fraud, misuse of frauds.
- c) To ascertain that full value received for money spent.
- d) Legal and administrative requirements should be fulfilled.

8. Government expenditure audit: - Following matters shall be verified in this regard.

- **Audit against rules & order:-** The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
- **Audit of sanctions:-** The auditor has to ensure that each item of expenditure is covered by sanction, either general or special by competent authority.
- **Audit against provisions of frauds:-** Ensure that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
- **Property audit:-** The auditors aims to bring out the cases of improper, avoidable or anfractuious expenditure cases of improper, available on infractions expenditure even they are duly sanctioned or not.
- **Performance audit:** - Objective of this audit is examination of the financial and operational performance of an organisation, programme, authority or function an is to oriented towards identify opportunities for greater economy and effectiveness.

Role of C & AG (comptroller and audit of India) in the audit of a government company:-

- The auditor of Government Company is appointed by the C & AG of India.
- The C & AG have power u/s 143 of companies act, 2013 as follows:-
 - a) To direct the manner in which the company's accounts shall be audited by the auditor and to issue necessary guidelines and instructions.
 - b) To conduct a test audit of the company's accounts by a authorised person by it.
 - c) To demand additional necessary information for implementation of such test audit.

Propriety audit in the context of government audit:-

Under the property audit, the auditor try to bring out the cases of improper, avoidable or infructuous expenditure even these expenditures are sanctioned by competent authority or not.

In this regard, following matters shall be verified:-

1. The expenditure should not be prima facie more than the occasion demands.
2. No Authority should exercise its powers of sanctioning expenditure to pass on order which will be directly or indirectly to its advantage.
3. Public money should not be utilised for the benefit of a particular person or 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 recognised policy.

I. 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.
- Statutory Corporation created by specific statues such as LIC, Air India etc.
- And the Government companies set up under the companies act, 2013, for the purpose of conduct of audit.

CASE STUDY ON PERFORMANCE ANALYSIS

❖ RATIO ANALYSIS: -

A. PROFITABILITY RATIO: -

- a) Gross profit ratio = $\frac{\text{Gross profit}}{\text{Net sales}} \times 100$
- b) Operating ratio = $\frac{\text{Operating expenses}}{\text{Net sales}} \times 100$
- c) Operating profit ratio = $\frac{\text{Operating profit}}{\text{Net sales}} \times 100$
- d) Net profit ratio = $\frac{\text{PBT}}{\text{Net sales}} \times 100$
- e) Expenses ratio = $\frac{\text{expenses}}{\text{Net sales}} \times 100$
- f) Return on investment
ROI or ROC = $\frac{\text{Earning before interest and after Tax}}{\text{Average capital employed}}$
- g) Return on equity / on
Net worth. = $\frac{\text{PAT on total earning}}{\text{shareholders fund or networth}}$

Use as: -

$$\text{ROE} = \frac{\text{EAE}}{\text{Shareholders fund}}, \quad \text{RONW} = \frac{\text{PAT}}{\text{Networth}}$$

B. ACTIVITY RATIOS: -

1. Inventory turnover ratio = $\frac{\text{Net sales}}{\text{Average stock}}$ or $\frac{\text{COGS}}{\text{Average stock}}$
2. Debtors Turnover ratio = $\frac{\text{Average receivable}}{\text{Credit sales}} \times \text{No of days in the year}$
- Or $\frac{\text{Credit sales}}{\text{average receivables}}$
3. Creditors turnover ratio = $\frac{\text{Average payable}}{\text{Credit purchase}} \times \text{No of days in the year}$

$$4. \text{ Fixed assets turnover ratio} = \frac{\text{Net sales}}{\text{fixed assets}}$$

$$5. \text{ Working capital turnover ratio} = \frac{\text{sales (net)}}{\text{Working capital}}$$

$$6. \text{ Capital turnover ratio} = \frac{\text{Net sales}}{\text{Average capital employed}}$$

$$7. \text{ Total assets turnover ratio} = \frac{\text{Net sales}}{\text{Total asset}}$$

C. SOLVENCY RATIOS: long term solvency ratios:

$$\text{➤ Debt equity ratio} = \frac{\text{Total outside liability}}{\text{Net worth}}$$

$$\text{➤ Proprietary ratio} = \frac{\text{shareholders fund}}{\text{Total assets}}$$

$$\text{Total asset may be} = \text{FA} + (\text{CA} - \text{CC})$$

$$\text{➤ Fixed assets ratio} = \frac{\text{Net fixed assets}}{\text{Long term funds}}$$

$$\text{➤ Capital gearing ratio} = \frac{\text{Debt}}{\text{Debt} + \text{equity}}$$

D. SOLVENCY RATION: short term solvency ratios:

$$\bullet \text{ Current ratio} = \frac{\text{Current assets}}{\text{current liabilities}}$$

$$\bullet \text{ Liquidity ratio} = \frac{\text{Liquid asset}}{\text{Current liabilities} / \text{Liquid liabilities}}$$

$$\bullet \text{ Interest coverage ratio} = \frac{\text{EBIT}}{\text{Interest expenses.}}$$

$$\text{Liquid asset} = \text{CA} - \text{Inventory} - \text{Prepaid expenses}$$

$$\text{Liquid liabilities} = \text{CL} - \text{Bank OD} - \text{cash credit}$$

❖ WASTE MULPLIER :-

1. In many continuous process industries cost data are arrived at with complexity in the calculation.

2. A spinning unit of cotton textile industry has set of processing department like maxing and blow room, cording, drawing, combing, fly frames and ring frames.
3. Actually spinning unit comes under continuous process industry.
4. Mixing and blow room are the starting point when the raw material enters and comes out as a yarn in the ring frame section.
5. Obviously like every processing industry spinning mills certain amount of wastages is emerging out of production in each and every department.
6. It is segregated as usable waste and saleable waste apart from invisible loss.
7. While the usable waste and saleable waste can be measured physically, the invisible loss is found out from the input & output of raw materials after considering due weightage of saleable and usable waste.
8. The actual waste which is extracted from the machine process depends upon the impurities in the cotton. Thus the production process involves wastage has a routine or a cycle.
9. Wastage multiplier is that quantity of output from any process, which will be needed to get one unit of final output.
10. The formula to calculate process wise waste multiplier is as follows:-

$$= \frac{\text{concern process output}}{\text{Final output}}$$

❖ Computation of average capital employed:-

Particular	₹
Paid up share capital	XXX
Reserve & surplus (except revaluation Reserve and includes credit balance Of profit and loss) made out of profits	XXX
Less: Accumulated losses (including debit balance Of profit & loss AC)	<u>(XXX)</u>
Net worth	<u>XXXX</u>

❖ Computation of changes in Net worth:-

Particular	(₹)
Operating net worth	XXXX
Add: Increase in share capital	XXXX
Increase in reserves	<u>XXXX</u>
	XXXX
Less: Decrease in shares capital	(XXXX)

Decrease in reserve	(XXXX)
Closing net worth	<u>XXXX</u>

❖ Computation of Net sales :-

Particular	(₹)
Gross sale value	XXXX
Less: Following items, if included:-	
Sales return	XXXX
Indirect Taxes	XXXX
Octroi / Local taxes	XXXX
Produced from scrap	XXXX
Or waste	
Recoverable packing	<u>XXXX</u> (XXXX)
Or transport	
Charge etc net sales	<u>XXXX</u>

❖ Computation of PBT :-

By Direct method		By indirect method	
Sale / revenues	₹xxxx	PAT	₹xxxx
Less: All expenses except	xxxx	Add : Income Tax	₹xxxx
Income Tax			
PBT	<u>₹xxxx</u>	PBT	<u>₹xxxx</u>

❖ Computation of operating profit (EBIT):-

BY direct method		By Indirect method	
Operating revenue	₹xxx	PBT	₹xxx
Less: Operating expenses (except interest and income Tax)	(₹xxx)	Add: Interest	₹xxx
EBIT	₹ <u>xxxx</u>	EBIT	<u>xxxx</u>

❖ Computation of value addition:-

Particulars	(₹)
Net sales	xxxx
Add : Export incentive, if any	xxxx
Add/ less: Adjustment of finished stock	<u>xxxx / (xxxx)</u>
	Xxxx
Less : cost of bought out inputs :	
Cost of materials consumed	xxxx

Process material chemical	xxxx
Consumption of stores and spares	xxxx
Utilities (like power & Fuel)	xxxx
Others cost, if any	<u>xxxx</u>
Value addition	<u>xxxx</u>

Note: ignore the following in computation of value addition:-

- Rates and taxes (not rent, rate and taxes)
- Depreciation
- All salaries and wages
- Interest (except interest on working capital)

❖ Statement showing distribution of earnings to different heads:-

Particulars	(₹)
Value addition	xxxx
Add: other income	xxxx
Add: Extra ordinary income	xxxx
Total earnings available for distribution	xxxx

Now,

Distribution of earnings to:-

➤ Employees as salaries and wages, Retirement benefit, bonus, etc	xxxx
➤ Shareholders as dividend	xxxx
➤ Government as any Tax (Including rates and taxes)	xxxx
➤ Extra ordinary expenses (not Deducted in value addition)	xxxx
➤ Others if any	xxxx
Retained earnings (b/f)	xxxx
Total earnings available for distribution	xxxx

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:

(₹ In lakhs)

	31.03.2018	31.3.2017	31.03.2016
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.

Illustration 2

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

Year ended 31st March	2018	2017
	(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, 2018 and March 31, 2017:

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

Illustration 3

In the Financial Accounts of Chemicals & Fertilizers Ltd. for the year ended March 31, 2018 the profit was ₹898,07,500. 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, 2018.

Illustration 4

Auto Parts Manufacturing Company Ltd. showed a profit for the year 2017-18 as ₹ 35,46,700. During the course of Cost Audit, the following transactions were noticed:

- (i) an old machine with net value of ₹ 6,54,000 was sold off for ₹ 9,30,000,
- (ii) dividend income was received amounting to ₹ 84,500 from investments,
- (iii) a sum of ₹ 58,000 was spent towards CSR commitment,
- (iv) the company was engaged in trading activity where purchase of goods was ₹13,50,000 and sales was ₹13,42,300, after incurring ₹ 40,800 as expenditure,
- (v) some renovation work was carried out at a cost of ₹ 7,75,000 and its useful life was only for five years, and
- (vi) the closing inventory of raw material was undervalued ₹ 29,600 and that of finished goods was overvalued ₹ 65,400 in the financial records. Work out the Profit as per the Cost Accounts.

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.

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

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
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 -

- i. Production overheads have been allocated to the production at 20% on Prime Cost.
- ii. Administration overheads have been charges at Rs. 3 per unit on units produced.
- iii. 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.

Illustration 8

ABC Ltd. provides you the following information as per Cost Books and Financial Books:

	As Per Cost Books Rs	As Per Financial Books Rs
(a) Opening Stock of raw-materials	50,000	45,000
(b) Closing Stock of raw-materials	60,000	54,000
(c) Opening Stock of work-in-progress	70,000	80,000
(d) Closing Stock of work-in-progress	80,000	90,000

(e) Opening Stock of finished goods	90,000	95,000
(f) Closing Stock of finished goods	1,00,000	1,06,000
(g) Factory Overheads	1,00,000	1,20,000
(h) Office & Adm. Overheads	1,10,000	1,00,000
(i) Selling & Distribution Overheads	1,20,000	1,00,000
(j) Interest and Dividend on	—	10,000
(k) Bad Debts written off	—	5,000
(l) Preliminary Expenses written off	—	10,000
(m) Rent (credit)	—	5,000
(n) Transfer Fees received	—	5,000
(o) Legal Charges	—	5,000
(p) Interest on Loan Funds & Mortgages	—	5,000
(q) Income Tax provided	—	6,000
(r) Loss on sale of Machine	—	7,000
(s) Stores Adjustments (credit)	—	18,000

Required: Prepare Reconciliation Statement in each of the following alternative cases:

Case I. If Cost Accounts showed a Net Profit of Rs.1,00,000

Case II. If Cost Accounts showed a Net Loss of Rs.1,00,000

Case III. If Financial Accounts showed a Net Profit of Rs. 1,00,000

Case IV. If Financial Accounts showed a Net Loss of Rs. 1,00,000.

Illustration 9

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

- (i) Some Old assets sold off which fetched a profit of ₹ 1,25,000
- (ii) Interest was received amounting to ₹ 45,000 from outside the business investment.
- (iii) Work-in-progress valuation for financial accounts does not as a practice take into account factory overhead. Factory overhead is ₹ 2,15,000 in opening W-I-P and ₹ 2,45,000 in closing W-I-P.
- (iv) The Company was engaged in Trading activity by purchasing goods of ₹ 11,15,845 and selling at ₹ 13,12,850 after incurring ₹ 35,000 as expenditure.
- (v) A major overhaul of machinery was carried out at a cost of ₹ 5,50,000 and next such overhaul will be done only after five years.
- (vi) Opening stock of raw material and finished goods was overvalued for ₹ 2,00,000 and closing stock was overvalued ₹ 1,85,000 in financial records.

Work out the profit as per Cost Accounts.

Illustration 10

Burnet Ltd., a manufacturing unit, provides the following extracts from its records for the year ended March 31,2018:

The Company's specifications capacity for a machine per hour	1,500 units
No. of shifts (each shift of 8 hours)	3 shifts
per day	
Paid Holidays in a year (365 days):	52 days
(i) Sunday	12 days
(ii) Other holidays	—
Annual maintenance is done within these holidays	
Preventive weekly maintenance for the machine is carried on	1 hour
during Sundays	75.7
Normal idle capacity due to lunchtime, shift changes etc. per shift	0
Production based on sales expectancy in past 5 years (units in Lakh):	87.4
	2
	65.3
	8
	77.9
	7
	76.0
Actual Production for the year (units in lakh)	8
	81.50

You are required to calculate:

- (i) Installed Capacity
- (ii) Practical Capacity
- (iii) Actual Capacity (%)
- (iv) Normal Capacity
- (v) Idle Capacity (%)
- (vi) Abnormal Capacity

Keeping in view of the relevant Cost Accounting Standard (CAS-2)

Illustration 11

The following data have been available of Sunflag Dolon Limited:

	2015 - 16	2016 - 17	2017 - 18
Installed Capacity—Ton	250	250	250
Production—Ton	240	230	125
Cost Per Ton (₹)	1,000	1,077	1,660

The poor capacity utilisation in 2017-18 was due to abnormal power-cut. The escalation in costs were 5% in 2016-17 and 7% in 2017-18 based on 2015-16

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

Illustration 12

GLORY LTD., a manufacturing company provides the following extracts from its Cost Accounting Records for the year ended March 31, 2018:

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)	
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, 2018:	158.80

You are required to calculate:

- (1) Installed Capacity
- (2) Practical Capacity

- (3) Actual Capacity (%)
- (4) Normal Capacity
- (5) Idle Capacity (%)
- (6) Abnormal Capacity—
—Keeping in view of the relevant Cost Accounting Standard (CAS-2)

Illustration 13

The following particulars pertaining to production of yarn are extracted from the records of Balarampur Textiles Ltd. for the year ended March 31, 2018:

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
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 14

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, 2018.

(₹ 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:

- (i) 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

Also Assessable Value for the purpose of paying GST on applicable transactions

Illustration 15

Purchase of Materials ₹ 3,00,000 (inclusive of GST of ₹ 15,715); Fee on Board ₹ 12,000; Import Duty paid ₹ 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 16

Purchase of Materials \$ 50,000 [Forward contract rate \$ = ₹64.40 but \$ = ₹64.60 on the 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 17

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 ; Abnormal Loss due to absorption of moisture before receipt of materials 100 units. Calculate the value of Closing Stock (Average Cost Method).

Illustration 18

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 2017-18, determine the employees cost according to CAS -7.

₹ in Lakh

(i) Salary, wages and other allowances	750
(ii) Bonus	100
(iii) Contribution to Provident Fund	90
(iv) Wages to contractors employees	100
(v) Employees welfare	40
(vi) Abnormal cost due to strike	80
(vii) VRS payment for closure of Rod Iron section of the plant	62
(viii) Arrear Salary (2016-17)	210
(ix) Compensation paid against the past periods against Court order	67

Illustration 19

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 @ ₹ 20,000pm
- (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.

Illustration 20

A Company introduced a new product EZY with advanced technology in a product market where there is huge competition with many competitors having individual market share 5% to 10%. Survey on the present market estimates that demand will increase of 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 present rate :
Material cost :

₹ 65 and Labour Cost ₹ 45. Overheads are absorbed on the basis of normal capacity. The following relevant information is given :

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

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

You are required to suggest the price so as to take care of competition in the right perspective.

Illustration 21

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

	Dept A	Dept B
Direct Material	₹ 240	₹ 200
Direct Labour rate/hrs	₹ 120	₹ 100
Direct Labour hrs	2 hrs	3 hrs
V OH per hour	₹ 50	₹ 30

Fixed per hour (based on 100% capacity)	₹ 60	₹ 40
Value of Machine on revaluation	₹ 40 Lakh	₹ 28 lakh

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

Target volume of production in the 1st year 2000 units @ 25%

capacity Variable S & D cost is ₹ 3 lakh for 2000 units.

Expected return on investment 24%.

Suggest on pricing of new product for new one or the existing ones at 80% capacity.

Illustration 22

The financial books of a Electrical goods manufacturing company reveal the following data (in Rupees) for theyear 2017-18 closing on 31st March 2018.

Opening Stock : Finished Stock 875 unit	74,375
Opening WIP : Work-in-progress	32,000
Sales 14,500 unit	20,80,000
Raw Materials	7,80,000
Direct Labour	4,50,000
Factory Overheads	3,00,000
Administrative overheads	2,95,000
Selling & Distribution overheads	61,000
Bad debt	12,000
Interest Received	45,000
Rent received	18,000
Closing Stock : Finished stock 375 units	41,250
Closing stock : WIP	38,667
Dividend Paid	85,000

Cost Records provide as under :

- (i) Factory Overheads is absorbed at 60% of direct wages
- (ii) Administrative Overheads are recovered at 20% of factory cost.
- (iii) Selling & Distribution overheads are charged at ₹ 4 per unit sold
- (iv) Opening stock of finished goods is valued at ₹ 104 per unit.
- (v) WIP is valued at factory cost both for Financial and Costing Profit Loss A/C.

Required :

- (i) Prepare Profit & Loss A/C as per Financial records and Costing records.

Prepare a Reconciliation Statement for Profits under above two different records

Illustration 23

The Balance Sheet of X Ltd. stood as follows as on:

(Rupees in Lakhs)

Liabilities	31 March 2018	31 March 2017	Assets	31 March 2018	31 March 2017
Capital	1,500	1,500	Fixed Assets	2,400	1,800
Reserves	696	600	Less: Depreciation	840	600
Loans	600	720	Net Fixed Assets	1,560	1,200
Creditors & Others			Investment	240	180
Current Liabilities	774	150	Stock	720	600
			Debtors	420	300
			Cash & Bank	120	120
			Other Current assets	150	150
			Miscellaneous Expenditure	360	420
	3,570	2,970		3,570	2,970

You are given the following information for the year 2017-18:

	(Rupees in Lakhs)
Sales	3,600
Profit before Interest & Tax	900
Interest	144
Provision for Tax	360
Proposed Dividend	300

Required:

- (i) Calculate for the year 2017-18:
 - A. Return on Capital Employed.
 - B. Stock Turnover Ratio.
 - C. Return on Net Worth.
 - D. Current Ratio.
 - E. Proprietary Ratio

Illustration 24

From the following figures extracted from the financial and cost accounting records, you are required to compute:

- (i) Value Added.
- (ii) Ratio of Operating Profit to Sales.
- (iii) Ratio of Operating Profit to Value Added.

Particulars	₹ in lakhs
Net Sales	42,000
Increase in Stock of finished goods	500
Expenses:	
Raw Materials consumed	8,600
Packing materials consumed	2,560
Stores and spares consumed	1,120
Power and fuel	9,200
Insurance	240
Direct salaries and wages	960
Depreciation	1,770
Interest paid	2,796
Factory overhead:	
Salaries and wages	480
Others	500
Selling and distribution expenses:	
Salaries and wages	240
Administration overheads:	
Salaries and wages	240

Illustration 25

M Ltd has the following Balance Sheets as on 31 March 2018 and 31 March 2017:

Particulars	₹ in lakhs	
	31 March 2018	31 March 2017
Sources of Funds:		
Shareholder's Fund	4,954	3,144
Loan Funds	7,740	6,766
	12,694	9,910
Applications of Funds:		
Fixed Assets	7,132	6,000
Cash & Bank	1,178	1,140
Debtors	3,190	2,536
Stock	5,934	5,014
Other Current Assets	3,334	3,008
Less: Current Liabilities	(8,074)	(7,788)
	12,694	9,910

The Income Statement of the M Ltd for the year that ended is as follows:

	₹ in lakhs	
	31 March 2018	31 March 2017
Sales	44,530	27,964
Less: CGS	41,920	25,288
GP	2,610	2,676
Less: Selling, General & Administrative Expenses	2,070	1,304
Earnings before Interest and Tax (EBIT)	540	1,372
Less: Interest Expense	226	210
Profit before tax	314	1,162
Less: Tax	46	384
Profit after Tax	268	778

Required:

- (i) Calculate for the year 2017-18
 - a. Inventory Turnover Ratio
 - b. Return on Net worth

- c. ROI
 - d. ROE
 - e. Profitability ratio
- (ii) Give a brief comment on the financial position of M Ltd.

Illustration 26

The following are the process wise wastages on inputs in a Spinning Mill in the year 2017-18.

Process	% age of Wastages on Input
Blow Room	9.18
Carding	7.17
Drawing	1.10
Roving(Simplex)	0.30
Ring Frame(Spinning)	7.21
Reeling and Winding	1.50

From the above, calculate the process wise waste multiplier factor

Illustration 27

The following are the process-wise input and output in a Spinning Mill -

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

Calculate the processwise Waste Multiplier factors

Illustration 28

From the following figures extracted from the financial and cost accounting records, you are required to compute:

- (i) Value Added.
- (ii) Ratio of Operating Profit to Sales.
- (iii) Ratio of Operating Profit to Value Added.

Particulars	₹ in lakhs
Net Sales	21,000
Increase in Stock of finished goods	250
Expenses:	
Raw Materials consumed	2,600
Packing materials consumed	1200
Stores and spares consumed	560
Power and fuel	4,600
Repairs and maintenance	200
Insurance	120
Direct salaries and wages	480
Depreciation	885
Interest paid	1,398
Factory overhead:	
Salaries and wages	240
Others	250
Selling and distribution expenses:	
Salaries and wages	120
Others	1,700
Administration overheads:	
Salaries and wages	120
Others	80

