

FINAL EXAMINATION

(REVISED SYLLABUS - 2008)

GROUP - IV

Paper-17 : COST AUDIT & OPERATIONAL AUDIT

Section I : Cost Audit

Q1. State whether the following statements are 'True' or 'False'. No reasons or justifications need be given :

- (i) Under the existing regulations, a Cost Accountant in practice, who is also a Chartered Accountant can also practice as a Chartered Accountant.
- (ii) The Cost Auditor is a member of the Audit Committee of the company.
- (iii) Managing Directors' remuneration paid as a percentage of profit is includible under salaries & wages in Cost of Production.
- (iv) The Cost Auditor is appointed by the Board of Directors with the approval of the Central Government.
- (v) A person can hold certificate of practice in either ICWAI / ICAI.
- (vi) A Cost Accountant cannot act as an Internal Auditor of the same company.
- (vii) A Cost Accountant in practice has to keep the monies of his client in a separate bank account.
- (viii) An aggrieved Cost Accountant in practice has the right to appeal to the High Court on the nature of punishment awarded to him by the Council of ICWAI.
- (ix) The detailed provisions relating to the regulation of Cost Audit in India are contained in section 233B read with section 227(1) of the Companies Act.
- (x) The work of Cost Auditor and Financial Auditor is partly interrelated.
- (xi) The Cost Auditor is appointed by the general body at the Annual General Meeting.
- (xii) A group of Cost Accountants can form a private limited company for undertaking Cost Audit Work.
- (xiii) Goodwill included in fixed assets to be excluded in computing Capital Employed.
- (xiv) A Cost Auditor of a company can also be its Internal Auditor.
- (xv) A company manufacturing a number of products which are subject to Cost Audit, can appoint different Cost Auditors for different products.
- (xvi) A firm of Cost Accountants can be constituted only with the previous approval of the Central Council of the ICWAI.
- (xvii) The Central Government has the power to reject the proposal of a company for appointment of Cost Auditor.

Answer 1.

- (i) False
- (ii) False
- (iii) False
- (iv) True
- (v) True
- (vi) False
- (vii) True
- (viii) True
- (ix) True
- (x) True
- (xi) False
- (xii) False
- (xiii) True
- (xiv) False
- (xv) True
- (xvi) True
- (xvii) True

- Q2. (a) Under what conditions, will the appointment of cost auditor for conducting Cost Audit be appointed in firm's name? Who will authenticate such reports and how? Can a proprietary firm also be appointed as a cost auditor?**
- (b) Can Cost Auditor of a company also be its internal auditor? Justify your answer.**
- (c) Can a Cost Accountant who is appointed as the concurrent auditor of a company accept appointment as cost auditor of the same company?**

Answer 2.

- (a) Appointment of cost auditor under a firm's name will be subject to the following conditions:
- (i) All the partners of the firm are full time cost accounting practitioners within the meaning of Sections 6 and 7 of the Cost and Works Accountants Act, 1959.
 - (ii) The firm must have been constituted with the previous approval of Central Government or of the Central Council of ICWAI as per amended regulation 113 of the Cost and Works Accountants Act, 1959.

The Cost Audit Report shall be signed by any one of the partners of the firm responsible for the conduct of the cost audit in his own hand for and on behalf of the firm. In any case the report should not be signed by merely offering the firm's name.

With the amendment to Regulation 108 of the ICWAI Regulations on 25.9.93, a proprietary firm can be approved by the Council of the Institute and therefore can be appointed as Cost Auditor.

- (b) Since the Cost Auditor is required to comment on the scope and performance of internal audit it would tend to militate against proper and dispassionate discharge of the duties of the cost auditor if he is also the Internal Auditor of the audited company. Hence the cost auditor of a company cannot be its internal auditor also.

- (c) A concurrent auditor may be viewed as a person holding an office of profit of the company and so cannot be appointed as the cost auditor of the same company.

Q3. Can you consider “Cost Audit” :

- (a) as Management Audit,**
- (b) as Social Audit,**
- (c) as Propriety Audit? If so, to what extent?**

Answer 3.

(a) Cost Audit and Management Audit :

Cost audit report and the information to be furnished therein is prescribed by the Central Government. However, most of the information contained in the cost audit report is relevant for making managerial decisions. Normally a management audit is an audit for the management and by the management. Such audit looks into the economy and the effectiveness of performance of various activities of an organization. Cost audit also looks into the effectiveness of performance and efficiency in various areas such as capacity, input costs of materials, utilities and other controllable areas so far as the manufacturing aspect is concerned. Detailed information on these areas has to be given in the cost audit report by the cost auditor comparing it with the standards and past actuals wherever necessary. Since Cost Audit is very useful to the management as it points out areas where performance can be improved, it can be called an audit for the management. Though cost audit is not done at the behest of the management, it does not change its character from being a management tool.

(b) Cost Audit and Social Audit :

Social audit is generally defined to be the audit of data or information depicting social performance of a business in contrast to its normal economic performance as measured in financial audit.

A lot of research and experimentation are being conducted to device techniques or models, which can measure the contribution of an enterprise to the society. These developments result from an increasing realization of the fact that business undertakings have social responsibilities also and that the performance as a whole should be seen in this context.

Social performance is discharged by providing some social amenities for the use of community as a whole e.g. provision of a hospital, a recreation club, a temple, etc. As provision of such amenities involves diversion of profits earned by the business for charitable or philanthropic purposes, it is advisable to conduct an audit of such expenses spent on welfare which are in no way related to the main task of business of production or marketing of goods/services and earning profits. Such activities, which apparently are not directly connected with the main business activity, help the business to create a favorable image for the business and those at the helm of affairs.

Cost audit provides an adequate information on the cost of production, selling price and margin of profit in respect of each item of product covered by cost audit. This information is very useful to the Government in regulating the prices of essential commodities. Therefore, cost audit can be said to subserve the interest of the community by facilitating the review of prices to be charged to the customer. A review by the government results in fair prices to the consumers which is a major social objective which cost audit is subserving. Thus cost audit is also a social audit.

(c) Cost Audit and Propriety Audit :

Propriety audit stands for verification of transactions in the best interest of the public, commonly accepted customs and standards of conduct. The term "propriety" has been defined by Kholer as "that which meets the tests of public interest, commonly accepted customs and standards of conduct and particularly as applied to professional performance, requirements of Government regulations, and professional codes." The tests boil down to consideration of financial prudence and economy, instead of too much dependence on documents, vouchers etc. It shifts the emphasis to find the wisdom and appropriateness of expenditure, rather than verifying whether it has been duly authorized or evidenced by proper vouchers etc.

In other words, the propriety audit seeks to ensure that the planned expenditure would yield the optimum returns and there is no other better alternative available. It seeks to ensure that the expenditure is not only appropriate to the circumstances of each case, it has indeed achieved the objectives for which it has been incurred. The audit of public sector undertakings as undertaken by the Comptroller and Auditor-General of India is the best example of propriety audit.

The Cost Audit Reports can be termed as propriety audit as these reports seeks to ensure that actual expenditure at each stage is appropriate and optimum returns have been achieved. The cost auditor always aims at ensuring that the actual expenditure should not be *prima facie* more than what the occasion demands. The cost auditor has to report on matters which appear to him to be clearly wrong in principle, cases where the company's funds have been used in a negligent or inefficient manner, arm's length pricing of related party transactions, etc. These are the areas where the propriety aspect is involved and therefore cost audit may be in the nature of "propriety audit".

Q4. State, whether the following statements are 'True' or 'False'. No reasons or explanation need be given :

- (a) Every company required to maintain Cost Records under section 209(1)(d) of the Companies Act is required to get such records audited under section 233 B of the Companies Act.
- (b) There is a set of Cost Accounting Records Rules prescribed under section 209(1)(d) of the Companies Act, which is applicable to all the Companies requiring Cost Audit.
- (c) Royalty is an item of Cost of Production under the Cost Accounting Records Rules.
- (d) Cost Audit is statutorily recognized form of audit in most of the country.
- (e) No Government Approval is required for reappointment of a Cost Auditor for the second or subsequent years.
- (f) According to Cost Accounting Record rules, inter-divisional transfer of intermediate products should be effected at market price.
- (g) A small scale unit manufacturing shaving cream on contract basis for a large scale multinational company need not maintain Cost Accounting Records under section 209(1) (d) of the Companies Act.
- (h) A large scale footwear unit in the co-operative sector need not maintain cost accounting records.
- (i) Cost Records are not maintained even maintenance has been prescribed and order not issued.

- (j) Cost Accounting Record Rules once applicable to a company require cost accounting records to be maintained year after year on a continuous basis.

Answer 4.

- (a) False
- (b) False
- (c) True
- (d) False
- (e) False
- (f) False
- (g) True
- (h) True
- (i) False
- (j) True

Q5. Reliance Petroleum Ltd. has its own power generation plant using steam. The data relating to the same for the period 2007-08 are :

Productions	Steam	Electricity
Unit	27,000	15,000
Cost :	Rs	Rs
A. Fuel		
(i) Coal	2,160	—
(ii) Others	648	—
B. Steam	—	1,800
C. Utilities		
(i) Gas	2,430	—
(ii) Electricity	432	—
(iii) Others	270	300
D. Fixed costs	810	300
	<u>6,750</u>	<u>2,400</u>

The State Electricity Board has offered electricity at a concessional rate of Rs 0.12 per unit between 10 pm and 6 am (third shift) as against the normal rate of Rs 0.18 per unit for the rest of the period.

Discuss the implications of accepting the offer assuming that utilities costs are partly fixed to the extent of 25%. If utilities were fully variable, what would be the position?

Solution :**Cost per unit of power generated:**

$$\begin{aligned}
 &= \text{Cost of (Steam + Electricity + Others)} / 15000 \text{ units} \\
 &= \text{Rs. (1800 + 300 + 300) Lakhs} / 15000 \text{ units} \\
 &= \text{Re 0.16}
 \end{aligned}$$

Average cost per unit of power purchased:

$$\begin{aligned}
 &= \text{Rate (From 10 pm to 6 am)} + \text{Rate (From 6 am to 10 pm)}/\text{Total Hours} \\
 &= \frac{(0.12 \times 8 \text{ Hrs.} + 0.18 \times 16 \text{ Hrs.})}{24} \\
 &= \frac{.96 + 2.88}{24} \\
 &= \text{Re } 0.16
 \end{aligned}$$

Hence, the Cost of generated power and average Cost of purchased power are equal. Thus, purchasing power during the third shift period, i.e. 10 pm to 6 a.m. is cheaper.

Q6. There was a strike from 13.09.2008 to 16.11.2008 in a company of which you were the Cost Auditor for the year ending 31.03.2009. Although the company began working from 17.11.2008, production could effectively begin only from 5.12.2008. The expenses incurred during the year ended 31.03,2009 were :

	Rupees (Lakhs)
Salaries & Wages (direct)	300
Salaries & Wages (indirect)	200
Power (variable)	120
Depreciation	180
Other Fixed Expenses	240

Detailed examination of the records reveals that of the above, the following relate to the period 13.09.2008 to 16.11.2008 :

	Rupees (Lakhs)
Salaries & Wages (indirect)	70
Depreciation	60
Other Fixed Expenses	90

Calculate the amount which in your opinion should be treated as abnormal for exclusion from the product costs.

Solution :

Calculation of fixed expenses incurred during 17.11.08 to 04.12.08 :

	Rupees (Lakhs)
Total expenses 2008-09	1,040
Variable expenses (electricity)	<u>120</u>
Fixed expenses 2008-09	920
Fixed expenses during strike period	<u>220</u>
Fixed expenses during non-strike period	<u>700</u>

Since the strike period was for 65 days, the non-strike period is 300 days. Hence, fixed expenses attributed to 18 days i.e. 17.11.'08 to 04.12.'08 is 6% of Rs 700 Lakhs i.e. 42 Lakhs.

Therefore, expenses incurred during 13.09.2008 to 16.11.2008	Rs 220 Lakhs
Fixed expenses incurred during 17.11.2008 to 04.12.2008	Rs 42 Lakhs
Total	Rs 262 Lakhs

Thus, in my opinion, Rs 262 Lakhs is to be treated as abnormal cost and to be excluded from product cost.

Q7. Kemp & Co. Ltd. operates a small machine shop that manufactures one standard product available from many other similar businesses as well as products to customer order. The accountant has prepared the annual statement shown here :

	Custom sales	Standard sales	Total sales
Sales	50,000	25,000	75,000
Material	10,000	8,000	18,000
Labour	20,000	9,000	29,000
Depreciation	6,300	3,600	9,900
Power	700	400	1,100
Rent	6,000	1,000	7,000
Heat and light	600	100	700
Others	400	900	1,300
Total expenses	44,000	23,000	67,000
Net income	6,000	2,000	8,000

The depreciation charges are for machines used in the respective product lines. The power charge is apportioned on the estimate of power consumed. The rent is for the building space, which has been leased for ten years at Rs. 7,000 year. The rent as well as heat and light are apportioned to the product lines based on the amount of floor space occupied. All other costs are current expenses identified with the product line causing them.

A valued custom parts customer has asked Kemp & Co. Ltd. if its shop would manufacture 5,000 special units. Kemp & Co. Ltd. is already working at capacity and would have to give up some other business in order to take this business. The company cannot refuse on custom orders already agreed to, but it could reduce the output of its standard product by about one-half for one year while producing the specially requested custom parts. The customer is willing to pay Rs. 7 for each part. The material cost will be about Rs. 2 per unit, and the labour will be Rs. 3.60 per unit. Kemp & Co Ltd. will have to dish out Rs. 2,000 for a special device, which will be discarded when the job is done.

Calculate and present the following costs :

- The incremental cost of the order,
- The full cost of the order,
- The opportunity cost of taking the order.

Solution :

(a) Differential Cost Analysis :

Cost of special job :

	Rs.
1. Material cost (5,000 @ Rs. 2)	10,000
2. Labour (5,000 @ Rs. 3.60)	18,000
3. Special expenses	<u>2,000</u>
Total	<u>30,000</u>

Costs reduced for standard products :

Material	4,000
Labour	4,500
Other costs	<u>450</u>
Total	<u>8,950</u>

Total incremental costs Rs. 30,000 – Rs. 8,950 = 21,050

It has been assumed that depreciation, rent, heat and light are fixed and will not be affected by the acceptance of the order.

(b) Calculation of the full cost of the order :

	Rs.
Special cost as shown in (a)	30,000
Depreciation	1,800
Power	200
Rent	500
Heat and light	<u>50</u>
Total	<u>32,550</u>

(c) The opportunity cost of accepting the order is the net cash flow given up :

	Rs.	Rs.
Sales of standard products		12,500
Less : Material	4,000	
Labour	4,500	
Power	200	
Other costs	<u>450</u>	<u>9,150</u>
Opportunity cost of special order		<u>3,350</u>

Q8. How are Cost Accounting Standards different from Cost Accounting Records Rules?

Answer 8.

Presently, separate Cost Accounting Records Rules have been prescribed with respect to each class of industry or product covered under section 209(1)(d). Total 44 products have so far been covered under the respective cost accounting record rules. Even though the rules broadly the similar, there are definitely differences amongst various rules, especially formats and treatment of certain items of expenditure. Therefore each rule has its own complexities. In any case, their coverage is limited to the selected companies only falling in 44 industries. However, Cost Accounting Standards on the other hand, shall be uniformly applicable to all the units including companies and are easier to understand besides being flexible and uniform. Therefore these will have much wider coverage.

Today, when most of the companies are multi-product organisations manufacturing or producing number of products, only one or two products only are generally covered under Cost Accounting

Records Rules. Both of them are covered under different rules and it becomes difficult for the companies to comply with the requirements. On the other hand Cost Accounting Standards shall be equally applicable to the companies and all products manufacturers. Therefore, many experts are of the view that prescription of Cost Accounting through Cost Accounting Standards with appropriate compliance audit or disclosure norms may be much more effective and useful than through complicated Cost Accounting Records Rule. Moreover, this will bring more numbers of companies under the ambit and will help the Government to achieve its objectives.

Q9. Your company has received an order from the Government of India directing your company to have the Cost Accounting Records audited. List the actions to be taken by the company step by step from appointment of Cost Auditor till the submission of The Cost Audit Report specifying the time schedule.

Answer 9.

- (i) The central government issues a specific order under section 233 B(1) of the Companies Act to a company to get its cost accounting records audited by a practicing Cost Accountant, indicating the product for which the audit is ordered and the year from which it is ordered. The order is automatically applicable for every subsequent year thereafter.
- (ii) On receipt of the order, the Board of Directors should select a Cost Accountant or a firm of Cost Accountants, and pass a resolution at the Board Meeting appointing the Cost Auditor. The Board may appoint the same Auditor for all products and factories covered by the order, or different auditors for different products or factories. It should be ensured that the auditor or auditors so appointed do not suffer any of the disqualifications under section 233 B (5), or exceed the number of audits u/s 224 (1) (B). The company should take a declaration from the auditor to this effect.
- (iii) The secretary of the company or a Director should make an application to the Central Government in Form 23-C, accompanied by the applicable fee, for appointment of the Cost Auditor. The application should be made within 45 days from the commencement of the accounting period/ year for which the audit is to be conducted, or from the date on which the order is received from the Government for the first time. Such an application should be made for every year thereafter.
- (iv) On receipt of the approval from the Government, the company should issue a letter to the auditor confirming his appointment and the remuneration agreed.
- (v) Within 90 days from the close of the accounting year, the company should make available all the Cost accounting records u/s 209(1)(d) to the auditor and render all assistance to him to carry out the audit.
- (vi) Within 135 days from the close of the accounting year, the company should prepare the Annexure to the Cost Audit (Report) Rules, 2001, get it audited and place before the Board of Directors. The approved Annexure and Proforma should be signed by one Director and Secretary and if there is not secretary, by two Directors.
- (vii) The Cost Auditor should submit his Report in the prescribed form along with the Annexure and proforma to the Government of India within 180 days from the close of the accounting year – in one hard copy and one soft copy.

Q10. The following figures relate to usage of power for a product :

	2007-08	2006-07	2005-06
Total power consumed in KWH	2402474	2494872	2175677
Rate / KWH (Rs.)	2.29	2.12	1.90
Total production in million (Kgs)	337.730	333.084	300.865

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

Answer 10.

	2007-08	2006-07	2005-06
Power consumed in KWH	2402474	2494872	2175677
Rate / KWH (Rs.)	2.29	2.12	1.90
Total power cost (Rs.)	55,01,665	52,89,129	41,33,786
Production in (million Kgs)	337,730	333,084	300,865
Power cost / MT (Rs.)	16.29	15.88	13.74
Power usage MT (KWH)	7.11	7.49	7.23

Variances over previous years :

Rate (Rs.)	4,08,420 (A)	5,48,872 (A)
Volume (Rs.)	73,774 (A)	4,42,678 (A)
Usage (Rs.)	2,69,658 (F)	1,63,793 (A)
Total (Rs.)	2,12,536 (A)	11,55,343 (A)

Q11. The abridged Balance Sheet and Profit & Loss Accounts of Narmada Papers Ltd. For the years 2007-08 and 2006-07 are given below :

Balance Sheet	Rs (lakhs)	
	2007-08	2006-07
Share Capital	6,500	6,500
Reserve & Surplus	37,063	35,122
Secured Loans	38,545	42,000
Unsecured Loans	5,720	6800
	87,828	90422
Gross Block	105060	105250
Depreciation	(40232)	(36200)
Capital Work in Progress	4515	1600
Investments	115	115
Current Assets, Loans & Advances	28870	32457
Current Liabilities & Provisions	(10500)	(12800)
	87828	90422

Profit & Loss Account

	2007-08	2006-07
Sales net of Excise Duty & Sales Tax	50,659	45,066
Other Income: Profit on Sale of Assets	105	64
Dividend Received	15	13
Sale of Scrap & Waste	280	320
Total	<u>51,059</u>	<u>45,463</u>
Expenses :		
Raw Materials, Stores & Spares		
And purchased Finished Goods	30,695	26,924
Salaries, Wages & Other employee Costs	2,003	1,721
Power & Fuel	3,788	3,144
Repairs & Maintenance	484	424
Other Manufacturing, administrative		
& Selling expenses (purchased goods & Services)	1,902	1,623
Interest	4,138	3,615
Depreciation	<u>4,032</u>	<u>4,514</u>
Total	<u>47,042</u>	<u>41,965</u>
Profit Before Tax	4,017	3,498
Provision for taxes & dividend	2,076	1,840

Analysis of financial accounts and Cost Accounting Records reveal the following additional information :

a) Revaluation of Reserve included in Reserve & Surplus	11,140	12,250
b) Loans repayable in 12 months included under 'Secured Loans'	4,250	4,750
c) Trading goods included in Inventory	3,120	2,712
d) Sundry Debtors for Trading activity included under Current Assets	2,080	2,820
e) Sundry Creditors for Trading activity included under Current Liabilities	1540	1810
f) Trading goods included in Sales	14,240	13,625
g) Cost of trading goods included under Material costs	10,680	9,810
h) The following expenses are allocated/ Apportioned to trading activity :		
Salaries & Wages	10%	
Selling Expenses	Rs. 280 Lakhs	
	(Prev Yr Rs. 214 Lakhs)	
i) Depreciation	5%	
j) Interest	20%	

Compute the following Ratios for reporting in Para 3 of the Cost Audit Report for the year 2007-08 (Ignoring Opening & Closing Stocks) :

- (i) Profit as a percentage of Capital Employed for the product;
- (ii) Value addition as a percentage of Sales.

Solution :

	Rs (in Lakhs)			
	31.03.2008		31.03.2007	
Capital Employed (for the product)				
Gross Block	105,060		105,250	
Less : Depreciation	40,232		36,200	
Revaluation Reserve	<u>11,140</u>		<u>12,250</u>	
Net Fixed Assets(A)		<u>53,688</u>		<u>56,800</u>
Current Assets, Loans & Advances	28,870		32,457	
Less : Inventories & Sundry				
Debtors allocated to trading	<u>5,200</u>	23,670	<u>5,532</u>	26,925
Current Liabilities & Provisions	10,500		12,800	
Add- Term Loans due in 12 months	<u>4,250</u>		<u>4,750</u>	
	14,750		17,550	
Less : Sundry creditors allocated to				
Trading activity	<u>1,540</u>	<u>(13,210)</u>	<u>1,810</u>	<u>(15,740)</u>
Net Current Assets (B)		<u>10,460</u>		<u>11,185</u>
Total Capital Employed (A + B)		64,148		67,985
Average Capital Employed	66,066			
[for 2007-08 = 64,148 + 67,985)/2]				

Profit :

(a) Profit from Trading Activity: (Figures for 2006-07 are not relevant for the problem)

Sales		14,240
Less : Materials	10,680	
Salaries & Wages	200	
Selling expenses	280	
Depreciation	202	
Total Cost	<u>828</u>	
		<u>12,190</u>
Profit from Trading		2,050

(b) Profit for the product under Audit :

Total profit for the company		4,017
Less : Trading profit	2,050	
Profit on sale of assets	105	
Dividend	<u>15</u>	<u>2,170</u>
Add-Interest (80% of Rs. 4,138)		1,847
		<u>3,310</u>
Profit for product as per Para 3		<u>5,157</u>

Value addition; as defined, is the difference between the *Net sale value* and *cost of bought out goods and services*. This would be equal to the total of profit before taxes, interest, depreciation, employee costs and turnover tax not recoverable, wherever applicable. Accordingly, value addition is worked out here, applying the concept :

	Rs (Lakhs)
Profit Before Interest & Taxes for the product as worked out before	5,157
Add : Employee costs (90% of 2003)	1,803
Depreciation (95% Of 4032)	<u>3,830</u>
Value addition	<u>10,790</u>
Sales :	
Total Sales net of ED	50,659
Less : Trading activity	<u>14,240</u>
Sales of product under Audit	<u>36,419</u>
Ratios :	
(a) Profit	5,157
Capital employed	66,066
Profit as % of capital employed for the product	7.80%
(b) Value Addition	10,790
Net Sales	36,419
Value addition as % of sales	29.63%

Q12. A manufacturing unit has two machines, viz. M_1 and M_2 . Machine M_1 be used for the production of either Product A or production B or both. Machine M_2 can be used for the production of either product X or product Y or both. In order to met the long term contractual obligations with one of its customers, the unit should produce a minimum quantity of 1,200 units each of A and B and 1,600 units each of X and Y.

The production and cost data for the year 1989 are :

Machine hours available : $M_1 = 7,800$ hours
 $M_2 = 7,300$ hours

	Product A	Product B	Product X	Product Y
Per unit of output :				
(a) Machine hours required	2	3	3	1
(b) Selling price (Rs.)	350	465	540	235
(c) Direct material cost (Rs.)	120	135	150	100
Per machine hour	M1		M2	
(a) Direct labour (Rs.)	65		80	
(b) Variable overhead (Rs.)	15		22	

Fixed overhead per annum Rs. 5 lakhs.

An additional expenditure involving a fixed overhead of Rs. 40,000 per annum will convert the M_1 and M_2 into a versatile centre so that any of the four products can be manufactured on these two machines.

As a management consultant advise whether conversion of machines should be undertaken or not.

Solution :

Statement showing Marginal cost and Contribution

	Product A	Product B	Product X	Product Y
Selling price Rs. (A)	205	465	540	235
Direct material cost Rs.	120	135	150	100
Conversion cost * Rs.	160	240	306	102
Marginal cost (B)	280	375	456	202
Contribution (A-B)	70	90	84	33
No. of machine hours	2	3	3	1
Contribution per machine hour	35	30	28	33

* Conversion cost = Direct labour + Variable overhead

For product A = $(65 + 15) \times \text{Rs. 2 Machine hrs.} = \text{Rs. 160}$

B = $(65 + 15) \times \text{Rs. 3} = \text{Rs. 240}$

C = $(80 + 22) \times \text{Rs. 3} = \text{Rs. 306}$

D = $(80 + 22) \times \text{Rs. 1} = \text{Rs. 102}$

Machine hours utilised by Machines M_1 and M_2

Machine M_1	Product A – hours	2,400	
	Product B – hours	3,600	
	Free hours	1,800	
	Total hours available	7,800	
Machine M_2	Product X – hours	4,800	
	Product Y – hours	1,600	
	Free hours	900	
	Total hours available	7,300	

After conversion at a cost of Rs. 40,000, the machines gain versatility so that any one of the four products A, B, X and Y may be produced in any proportion within the total machine hours available remaining unchanged. The preference will be to produce product making the largest contribution per machine hour. The choice is clearly in favour of Product A which makes a contribution of Rs. 35 per machine hour. Hence, free hours of Machine M_2 should be used to produce A instead of Y. This will result in additional contribution calculated as follows :

	Rs.
Contribution of A (900×35)	31,500
Less : Contribution of Y (900×33)	29,700
Additional contribution	1,800

If the machines are converted by incurring an additional expenditure of Rs. 40,000, there will be an additional contribution of Rs. 1,800 only. The conversion should not therefore be profitable.

Q13. State the steps taken by the International Auditing and Assurance Standards Board (IAASB) to improve the clarity of its standards.

Answer 13.

The International Auditing and Assurance Standards Board (IAASB) sets high quality international auditing and assurance standards in serving the public interest. The IAASB recognizes that standards need to be understandable, clear and capable of consistent application. These aspects of clarity serve to enhance the quality and uniformity of practice worldwide. The IAASB reviewed the drafting conventions used in its International Standards during the year 2003 seeking to improve its standards. The objective of the review was to identify ways to improve the clarity, and thereby the consistent application, of International Standards issued by the IAASB. The IAASB began a comprehensive program in the year 2004 to enhance the clarity of ISAs. This program involved the application of new drafting conventions to all ISAs, either as part of a substantive revision or through a limited redrafting to reflect the new conventions and matters of clarity generally.

The IAASB has issued amendments to the Preface to International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Preface). This document establishes the conventions to be used by the IAASB in drafting future International Standards on Auditing (ISAs) and the obligations of auditors who follow those Standards. Improvements arising from the amended Preface broadly comprise :

- Identifying the auditor's overall objective when conducting an audit in accordance with ISAs, setting an objective in each ISA, and establishing an obligation on the auditor in relation to those objectives; Clarifying the obligations imposed on auditors by the requirements of the ISAs and the language used to communicate such requirements;
- Eliminating any possible ambiguity about the requirements an auditor needs to fulfill; such possible ambiguity arose from the use of the present tense in the current ISAs; and
- Improving the overall readability and understand ability of the ISAs through structural and drafting improvements, including presenting the requirements and application and other explanatory material in separate sections within the ISAs.

The IAASB plans to complete the project by the end of 2009. This plan distinguishes between revision and redrafting. The redrafted or revised and redrafted ISAs will be effective for audits of financial statements for periods beginning on or after December 15, 2009.

Q14. Write in Brief :

- Bank Audit.**
- Concurrent Audit**
- Productivity Audit**
- Professional Misconduct**

- (e) Professional Behaviour
- (f) Corporate Service Audit
- (g) Due Diligence Audit

Answer 14.**(a) Bank Audit :**

Bank Audit in banks traditionally implies transaction audit i.e. verification of accounts based on flow of accounting transactions over a specified period of time, generally a period of 12 months. Banking business has undergone complete transformation during last two decades. The bank branches are no longer there for intermediary role only to mobilize funds from "surplus clients" and deploying these funds with the "deficient clients" for their business purposes. Today most of the commercial banks have embraced multi faceted financial services business like investment banking, treasury functions, project consultancy services, and insurance business etc.

The effective conduct of bank audit requires that a comprehensive audit programme be chalked out based on the size of the branch, volume of the transactions, status of computerization and the classification of the branch. The effective audit of banks require that the team members are familiar with the following :

- (a) Exact scope of work i.e. whether it is Concurrent Audit, Stock Audit, Revenue Audit, Credit Risk Audit or any other assignment etc.
- (b) RBI circulars relating to income recognition, asset classification and provisioning norms;
- (c) Accounts closing instructions issued to the branches by the Head Office of the concerned bank;
- (d) Guidelines issued to the auditors by the banks regarding certificates to be issued by them;
- (e) The accounting system of the bank and the relevant internal controls;
- (f) Salient features of Long Form Audit Report (LFAR);
- (g) Audit procedure to be adopted;
- (h) ICAI Guidance Note on bank audit;
- (i) Various checklists for audit of different operations,
- (j) Understanding the business of the branch with specific reference to applicable laws like:
 - (i) Banking Regulation Act, 1949;
 - (ii) Relevant State Co-operative Act;
 - (iii) Multi State Co-operative Act, 2002;
 - (iv) Service Tax Provisions; TDS Provisions under Income Tax Act;
 - (vi) Bank Cash Transactions Tax;
 - (vii) Prevention of Money Laundering Act, 2002.

The following areas are the critical areas in any bank audit :

- (a) Verification of Balance Sheet and Profit and Loss Account with main and subsidiary ledgers.
- (b) Verification of all closing returns with the ledgers and registers,
- (c) Review of inter-branch items and clearing differences,
- (d) Verification of all large NPA advances and the provisioning thereof,

- (e) Verification of all large advances granted during the year with specific reference to terms of sanction and documents,
- (f) Balancing of books,
- (g) PMRY (Prime Minister Rojgar Yojana) loans granted during the year.

(b) Concurrent Audit :

Concurrent audit is a systematic examination of financial transactions on a regular basis to ensure accuracy, authenticity and compliance with procedures and guidelines. It is an examination, which is contemporaneous with the occurrence of transactions or is carried out as near thereto as possible. The main focus of this audit is to ensure that transactions adhere to the system and laid down procedures. It serves the purpose of effective internal control as it reduces the time gap between occurrence of a transaction and its overview or checking. The concurrent audit is similar in nature to internal audit as both are generally initiated by the management itself. However, there is basic difference between the two i.e. concurrent audit is regular audit of financial transactions whereas internal audit is a periodic audit.

Sound internal controls are essential to the prudent operation of banks and to promote stability in the financial system as a whole. Concurrent Audit ensures that adequate internal controls within banking organizations are supplemented by an effective internal audit function, which independently evaluates the control systems within the organization. Concurrent Audit of Bank Branches involves checking of all aspects of banking and other operations on an ongoing daily basis to ensure that the Branch is adhering to the Bank's laid down systems and procedures. The Concurrent Auditors are responsible to examine and comment on all the areas specified by the Bank/RBI from time to time in regard to concurrent audit of branches. A copy of guidelines on the manner of conduct of audit is also provided at the time of allotment of concurrent audit and from time to time thereafter. Therefore, it ensures that all errors and frauds, if any are generally detected immediately after their occurrence to control the damage, if any.

(c) Productivity Audit :

The Productivity audit is basically an analysis of the productivity of the resources deployed by any organization. It is generally done to generate information about the status of productivity in the organization for the purpose of determining the scale of efficiency and effectiveness of 'resource utilization'. The term 'resources' here would include not only "money" but also "men", "machines", "materials" and "methods". In other words, the objectives of productivity audit is –

- (a) to attain optimum result, and
- (b) to improve on the benchmarks.

This audit would generally comprise –

- (a) comparison of expected returns on utilization of the resources vis-à-vis the actual returns;
- (b) comparison of optimum returns on utilization of the resources vis-à-vis the actual returns; and
- (c) the steps taken to improve benchmarks of returns and the utilization.

The term 'Productivity' is normally attributed only to the "productivity of labour" or "efficiency of labour" alone. But productivity audit is actually "productivity of every resource employed".

Productivity audit is done by –

- (a) Ratio analysis
 - Return on capital employed
 - Return on sales
 - Turnover ratios of fixed assets, current assets, inventories, category-wise debtors etc.,
- (b) Capacity utilization of plant, machinery and equipments against available capacity,
- (c) Productivity analysis of man (labour) hours in time and cost,
- (d) Material consumption against norms and benchmarks.

(d) Professional Misconduct :

A cost accountant in practice is one who is holding a certificate of practice under Sections 6 and 7 of the Cost and Works Accountants Act, 1959. If a person desires to practice as a Cost Accountant, he should apply to the Council of the Institute of Cost and Works Accountants of India in proper form and obtain a certificate of practice.

Each and every member of the profession in practice is required to follow certain professional ethics and code of conduct as prescribed by the Cost and Works Accountants Act, 1959 and regulations thereunder. Section 22 of the Cost and Works Accountants Act, 1959 defines that “professional or other misconduct” is deemed to include any act or omission provided in any of the Schedules but nothing in this section shall be construed to limit or abridge in any way the power conferred or duty cast on the Director (Discipline) under Section (1) of section 21 to enquire into the conduct of any member of the Institute under any other circumstances.

This definition under Section 22 of the Cost and Works Accountants Act, 1959 read with the two schedules to the Act clarifies or indicates that the schedules provide an illustrative list of acts and omissions constituting “professional or other misconduct” as Director (Discipline) is competent to enquire into the conduct of any member of the Institute under any other circumstances.

Similarly Para 2 of Para IV of the First Schedule provides that a member of the institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if in the opinion of the council he brings disrepute to the profession or the institute as a result of his action whether or not related to his professional work. In view of above, it is clear that the definition of misconduct is very wide and should be adhered in letter and spirit. The Acts or omissions constituting professional misconduct as defined in Section 22 are detailed in two schedules of the Act.

The First Schedule is divided into the following four parts :

- Part-I - Professional Misconduct in relation to Cost Accountants in practice;
- Part-II - Professional Misconduct in relation to Members of the Institute in Service;
- Part III - Professional Misconduct in relation to Members of the Institute Generally; and
- Part IV - Other Misconduct in relation to Members of the Institute Generally.

The Second Schedule requiring action by the Disciplinary Committee is divided into the following two parts :

- Part-I - Professional Misconduct in relation to Cost Accountants in practice;
- Part-II - Professional Misconduct in relation to Members of the Institute generally.

In addition to above, Para 1 of Part-II of the Second Schedule provides that a member of the institute, whether in practice or not, shall be deemed to be guilty of professional misconduct,

if he contravenes any of the provisions of this Act or the regulations made there-under or any guidelines issued by the council. Reference is also drawn to Cost Accounting Standards (CAS) issued by the Cost Accounting Standard Board of the ICWAI. These CAS are recommendatory in nature by the Council of ICWAI and every member of the Institute is expected to honour the same (Para 5 of the Preface to Cost Accounting Standard Board). Para 5.8 of the preface further provides that Cost Auditors will adopt and encourage the adoption of the standards, wherever applicable, in maintenance of Cost Accounting Records Rules under section 209(1) (d) and report the deviations, if any, in the Cost Audit Reports u/s 233B. Para 6.3 provides that disciplinary restriction may be imposed by the Council of the Institute at appropriate stages as may be felt necessary for not complying with or not honouring the standard. In view of above, it is clear that non-compliance of non-honouring of Cost Accounting Standards may also be termed as misconduct.

(e) Professional Behaviour :

The principle of professional behaviour imposes an obligation on professional accountants to comply with relevant laws and regulations and avoid any action that may bring discredit to the profession. This includes actions which a reasonable and informed third party, having knowledge of all relevant information, would conclude negatively affects the good reputation of the profession.

In marketing and promoting themselves and their work, professional accountants should not bring the profession into disrepute. Professional accountants should be honest and truthful and should not :

- (i) Make exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; or
- (ii) Make disparaging references or unsubstantiated comparisons to the work of others.

The conceptual framework requires a professional accountant to identify, evaluate and address threats to comply with the fundamental principles, rather than merely complying with a set of specific rules, which may be arbitrary. If threats to ethics are not clearly insignificant, a professional accountant should apply safeguards to eliminate the threats or reduce them to an acceptable level.

(f) Corporate Service Audit :

With the enlarged role assumed by corporate organization in this country, the corporate bodies are expected to have better social responsibilities than in the past.

The term "Corporate Services" refer to the activities that combine or consolidate certain enterprise-wise needed support services, provided based on specialized knowledge, best practices, and technology to serve internal (and sometimes external) customers and business partners viz. employees, shareholders, community, fellow businessman and government. Management auditor studies separately and properly, evaluate after critically examination of the different aspects of services and their extent that have been satisfactorily rendered by the corporate body and of evaluation of degrees of responsiveness and awareness on the part of such enterprise.

The areas of Corporate Service Audits are :

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

- iii. Shareholders — Safety of investment, satisfactory return, appreciation (in value, quantity & marketability),
- iv. Community — Social cost and social benefit, public relations,
- v. Fellow-businessman — Business ethics and fair trade dealings,
- vi. State/Govt. — Compliance with the spirit of laws, fair trade practices, payment of taxes.

(g) Due Diligence Audit :

Due diligence means care and precaution. In the context of Merger and Acquisition transaction, it means background checking or the intense examination of target asset for acquisition by a prospective buyer. Due Diligence Audit is a fact-finding audit to assist in taking the financial decision – whether to buy the target asset or how much price to pay for the acquisition or how to structure the financial transaction. The main objective is to verify the assertions made by the seller and to identify caveats which may not have been disclosed by the seller. A comprehensive due diligence audit will cover the following fields, as suggested by Luis F. Gillman :

- i. Compatibility Audit
- ii. Financial Audit
- iii. Macro-environmental Audit
- iv. Legal-environmental Audit
- v. Marketing Audit
- vi. Production Audit
- vii. Management Audit
- viii. Information System Audit
- ix. Reconciliation Audit

Q15. What are the differences between Accounting Records & Statistical Records? Is it compulsory to maintain statistical records under Cost Accounting Records Rules? If so, why?

Answer 15.

Difference between 'Accounting Records' and 'Statistical Records' :

'Accounting Records' refer to the Books of Account to be kept by a company with respect to : (a) all sums of money received and expended and the matters in respect of which the receipt and expenditure take place : (b) all sales and purchases of goods : (c) all assets and liabilities. They also refer to the books of account relating to utilization of material or labour or other items of cost as prescribed in the case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities.

Accounting records may be classified into two broad categories – Cost Accounting Records and Financial Accounting Records. Ordinarily, these are maintained in the form of 'registers' or 'loose leaf' sheets. The documents like, Bills, Cash Memos, Invoices, Vouchers, Cheque Counterfoils etc. also form part of the accounting records. In relation to the Cost Accounting Records Rules, the Books of Account specified in the Schedules I and II and the relevant Annexures and Proformae ledgers and memorandum accounts and trial balances etc. constitutes financial accounting records.

'Statistical Records' refer to those which contain statistical data – financial or non-financial accounting or non-accounting, collation of past periods information or computations out of them by relating one set of data with the other to convey any meaning or message. In relation to the Cost Accounting Records Rules, the statistical records may comprise those which are maintained to analyse and evaluate the matters like product-wise sales in quantity and value, product-wise/ process-wise wastes and rejections, machine utilization and stoppages, labour, overtime or idletime, process-wise overheads, input-output analysis, efficiency analysis, etc. Similarly, data contained in the schedules forming part of Balance Sheet (e.g. Share Capital, Reserves and Surplus, Loans, Fixed Assets, Capital goods-in-stock, Contingent Liabilities, Director's Remuneration, Employee remuneration details, Value of imports, Foreign exchange earning, lincensed/ installed production capacities and actual production, etc are also statistical records in nature and content.

It is interesting to note that the statistical records, in most cases, are the end products of the detailed accounting records and that they are generated to be maintained through the processes of summarization, collation, tabulation, computation and analysis to meet the requirements of internal management as well as the statutory requirements or various authorities.

Under the Cost Accounting Records, Rules, the maintenance of statistical records is compulsory due to the following reasons :

- (i) To enable the company to comply with the requirements of the Schedules I and II;
- (ii) To reconcile the date furnished to the Director General of Technical Development and the Central Excise and other Govt. authorities from time to time;
- (iii) To enable the cost auditor to report to the Company Law Board on all the points referred to in the Cost Audit (Report) Rules 1996; and
- (iv) To enable the Company to exercise control over operations and costs.

Section II : Operational Audit

Q1. State whether the following statements are 'True' or 'False':

- (i) According to guidelines on inventory valuation issued by ICWAI, work-in- Progress is not included in inventory.
- (ii) Corporate image and brand equity are closely related concepts.
- (iii) Secretariat of the WTO will be headed by a Secretary.
- (iv) Productivity is broadly defined as the ratio of production and sales.
- (v) For stock hypothecation to the bank, insurance coverage is required for Seventy-five percent of stock as margin money.
- (vi) The Ministerial Conference shall establish five functional committee for Discharge of functions agreed to them under the Multilateral Trade Agreements.
- (vii) The Special Audit Report under section 14A or 14AA of the Central Excise Act should be submitted in the prescribed form.
- (viii) While issuing certificate containing a number of pages and annexures, every page should bear the signature and seal of the Cost Accountant.
- (ix) In the process of decision making by WTO, the European Union shall have the number of votes equal to the number of its member states.
- (x) Corporate image of a company is built up exclusively by its product quality and not affected by its attitude towards its other stakeholders.
- (xi) Leather tanning industry is an industry causing above average environmental Pollution.
- (xii) In computing the cost of production for captive consumption, as per CAS-4, administrative overheads which are not directly related to production activity, may be excluded.
- (xiii) The objective of Internal Audit is not confined to detection of fraud, but extends to all areas of operational efficiency.
- (xiv) Operational Audit is merely an extension of Internal Auditing into Operational Areas.
- (xv) 'Dumping' is an illegal practice.
- (xvi) "Position Analysis" is one of the techniques used by the Management Auditor for evaluation of corporate image.
- (xvii) Ergonomics and Human Engineering are one and the same.
- (xviii) Both Authority and Responsibility can be delegated.
- (xix) Consumerism is a movement protecting the interests of the consumers.
- (xx) Dumping Duty is fixed in Dollars and not in Rupee.
- (xxi) "Organization Development" (OD) is a "Sensitivity Training" intervention.
- (xxii) In ABC system, the concept of 'Cost Centre' is very important.
- (xxiii) Concept of Corporate Governance has gained momentum now with the globalization and liberalization of the Indian economy since 1996.

Answer 1.

- (i) False - According to guidelines on inventory valuation issued by ICWAI, work-in- Progress is included in inventory.
- (ii) True – The statement is true.
- (iii) False- The secretariat of WTO will be headed by a Director-General.
- (iv) False – Productivity is broadly defined as the ratio of output to input.
- (v) False – For stock hypothecation to the bank insurance coverage is required for Full Value.
- (vi) False – The Ministerial Conference shall establish three functional Committees for discharge of functions agreed to them under the Multilateral Trade Agreements.

These are :

- a. Committee of Trade and Development
 - b. Committee on Balance –of-payments Restrictions.
 - c. Committee on Budgets, Finance and Administration.
- (vii) False – The form of Special Audit report will vary depending on terms of reference and type of industry.
 - (viii) True – The statement is true.
 - (ix) True – When the European Communities exercise their voting right to vote, they shall have a number of votes equal to the number of their member states which are members of the WTO.
 - (x) False – Corporate image implies the standing of a corporate body in all its fields of business from the judgmental view of its different stockholders.
 - (xi) True – The statement is true.
 - (xii) True – As per CAS-4, administrative overheads in relation to activities other than manufacturing activities e.g., marketing, projects management, corporate office expenses etc. shall be excluded from the cost of production.
 - (xiii) True – The statement is true.
 - (xiv) True – the objective of operational audit is to assist the organistaion in performing functions more effectively and economically with focus on the efficiency and effectiveness of operations, so it is merely an extension of internal audit.
 - (xv) False – ‘Dumping’ is an ‘unfair’ practice.
 - (xvi) True – The statement is true.
 - (xvii) True – The statement is true.
 - (xviii) False – Only authority can be delegated, responsibility can not be delegated.
 - (xix) True – The statement is true.
 - (xx) True – The statement is true.
 - (xxi) True – The statement is true.
 - (xxii) False – In ABC system, the concept of Activity centre and not ‘Cost Centre’ that is relevant.
 - (xxiii) False – Globalisation and Liberalisation began in India in the year 1991.

Q2. As a Cost Accountant in practice, you are asked to certify the cost of production for Captive Consumption. Briefly outline the procedure involved and statutory requirements to be complied with.

Answer 2.

The determination of cost of production for purpose of valuation of goods captively consumed is governed by the Cost Accounting Standard 4 (CAS 4), which has become mandatory. This standard should be read with other Cost Accounting Standards already issued viz.,

- CAS 1 - for classification of costs.
- CAS 2 - for capacity determination.
- CAS 3 - for apportionment of overheads.

Although the standard is applicable for valuation for all purposes such as transfer pricing, inventory valuation, segment performance, etc., it has been statutorily prescribed as the only method to be adopted for calculation of Central Excise Duty, under Rule 8 of the Central Excise Rules dealing with valuation. This rule determines the transaction value as 110% of the Cost of Production arrived at as per CAS-4.

The cost of production of manufactured goods is defined as the aggregate of materials consumed (net of recoveries for sale of scrap), direct wages and salaries, direct expenses, works overhead, quality control costs, R & D costs, packing costs and administrative overheads relating to production. "Captive Consumption" is defined as consumption of goods manufactured by one division or unit by another division or unit of the same organization or related undertaking for manufacturing another product.

The cost of production should be based on "normal capacity". In other words, the fixed costs shall be absorbed based on normal capacity or actual capacity utilization whichever is higher. Normal capacity is defined in CAS-2 as practical capacity minus the loss of production capacity due to external factors.

Where the cost records have been prescribed under sec. 209 (1) (d) of the Companies Act, the cost records shall be taken as the basis. In other cases, the format prescribed in CAS -4 may be followed for calculating the cost of production.

Q3. State whether the following Statements are 'True' or 'False':

- (a) Audit of Human Resource Development is outside the scope of Management Audit.
- (b) Management Audit imposes barriers in executive decision making.
- (c) Management Audit Report is presented to the management .
- (d) Management Audit Report is to be submitted to the Cost Audit Branch.
- (e) Broadly speaking, Internal Audit is a part of Management Audit.
- (f) The efforts which are directed towards humanizing and harmonizing the jobs and their content are collectively known as "Job Enlargement".
- (g) The concept of Management Audit was developed by T.G.Woods.
- (h) Consumerism is a movement protecting the interest of the consumers.

(i) **Energy Audit means monitoring the energy efficiency of different equipment and process.**

(j) **Principles of Management Audit remain valid irrespective of the nature of an enterprise.**

Answer 3.

- (a) False – The scope of management audit extends over all the functions of an organization viz. management, personnel, administration etc. So the audit of human resource development is not outside the scope of management audit.
- (b) False – Management Audit does not impose barriers in executive decision making, it appraise the management performance at all the levels and helps to spotlight the decision or activities, that are not in conformity with organisational objectives.
- (c) True - Management Audit Report is to be submitted to the Management of the concern.
- (d) False – Management Audit Report is to be submitted to the Management of the concern.
- (e) True – The statement is true.
- (f) False – The efforts, which are directed towards humanising and harmonizing the job and their content are collectively known as “Job Enrichment” and not “Job Enlargement”.
- (g) False – The concept of Management Audit was developed by T.G.Rose and not T.G.Woods.
- (h) True – The statement is true.
- (i) True – As energy audit gives suggestion how energy consumed can be cut down without affecting production.
- (j) True – Irrespective of the nature of an enterprise, the principles of Management Audit will remain valid.

Q4. (a) What is meant by ‘Social Responsibility Management’? Briefly list the different types of pollution for which a manufacturing company is responsible.

Answer 4.(a)

Corporate Social Responsibility :

As part of the infrastructure requirements for running any business or manufacturing industry, a company has to depend on the society and community of people living in the area in which the factory is situated. Therefore, the company owes a duty and responsibility for ensuring that the normal life of the community is not affected by the manufacturing process. Although the Government of the State and the Central Government have enacted legislations for prevention of environmental pollution and provision of safety measures, the company on its own should take measures for community development besides protection of environment. Many companies provide medical facilities and run educational institutions not only for their own employees, but also for the public in general in the areas in which they are operating. This is termed as Corporate Social Responsibility.

The following are some of the types of pollution which need to be prevented or controlled –

- (a) Air Pollution – caused by burning or letting out of chemicals in the air leads to respiratory diseases.

- (b) Water Pollution – caused by letting out of effluents in water bodies or agricultural lands by industries like Tanneries, Dyeing units etc., results in contamination of ground water making it unsuitable for human consumption and in pollution of quality of soil affecting agriculture.
- (c) Noise Pollution – by the running of heavy industries water well drilling etc. lead to loss of hearing and psychological disorders.
- (d) Thermal or Climate Pollution – caused by excessive heat generated in the manufacturing process will affect the environment resulting in deforestation or stunted plant growth.
- (e) Radiation Pollution – caused by Nuclear Power Plants will affect the health of the people living in the vicinity.

(b) Clearly explain the meaning of the two words “Truth & Fairness” as are used in an Audit Certificate.

Answer 4.(b)

According to Cost Audit Report Rules, a Cost auditor has to certify whether Co.'s accounting records have been properly kept so as to give a 'true and fair' view of the cost of production, processing, manufacturing or mining activities.

A financial auditor has also to state in his report whether in his opinion and to the best of his information and according to the explanations given to him, the said accounts give a 'true and fair view' in the case of balance sheet, of the state of company's affairs as at the end of the Co.'s financial year and in the case of Profit & Loss A/c. of the Profit/Loss for its financial year.

What constitutes “True and Fair view” has not been defined by the Companies Act. The phrase “True and Fair” in the Auditor's Report signifies that the auditor gives an opinion whether cost statements represent fairly the matter of auditor's judgment in the particular circumstances of a case. However, when the auditor describes any accounting statement/ record as “true and fair”, it means that he has satisfied himself in respect of the following :

1. The records put up adhere to the prescribed rules.
2. They are in conformity with the requirement of the Co.s' Act.
3. There is no misstatement nor any suppression of facts.
4. There is no breach of principles.

Q5. “Management Audit can be potent tool for managerial control and reduction of cost”. Do you agree with the above statement? Briefly comment on the potential of management audit as a tool for managerial control and reduction of costs.

Answer 5.

“Management audit may be more specifically defined as being an investigation of a business from the highest level downwards in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relationship with outside world and the most efficient organization and smooth running internally.”

Management Audit is the total examination of transaction of an organization, or parts of it, and includes checks on the effectiveness of managers, their compliances with company on

professional standard, the reliability of management data, the quality of performance of duties and recommendations for improvement. In this context, the distinction between administration and management should be recognized. Administration is concerned with the structure of the organization and the mechanism of its operations, whereas management relates to the leadership and direction of the people, the way in which they are controlled to exercise their functions within the administrative framework. The question of audit arises only because of the ownership of many companies is widely spread between a large number of shareholders, and the running of the organization lies with people holding comparatively a small portion of the equity. This dichotomy of dispersed ownership and entrenched management necessitates an examination to be done of the Management function itself by an independent authority. In this context management audit undertakes examination of the effectiveness of management in controlling the total activities of the organization in the accomplishment of the organization objectives. Since a number of audits is conducted in various areas, audit responsibility lies in avoiding any overlapping and selecting such areas not covered by an audit already, e.g., if internal audit examines adherence to procedures, management audit should examine the effectiveness of such procedures.

Management audit is the unique process appraising the performance of directors, managers or in other words, appraising the performance of the management. A working director is included as a manager for purposes of management audit. It is normally presumed to be a non routine investigation into a performance of a manager or group of managers. But in a number of organizations management audit is now a regular feature to examine and improve managerial effectiveness. It attempts to look into all aspects of the management performance. Management audit does not concentrate on financial matters alone as in the case of financial audit. It looks into the efficiency and effectiveness of performance in an organization.

In a developing country like India, management audit through CAG, public accounts committee and parliamentary committee on public undertakings, has helped the Government in identifying improper or wasteful use of funds, checking extravagant organization practices and curbing ineffective use of physical resources. Indian financial Institutions, banks and Board for Industrial Finance and Reconstruction (BIFR) have found management audit (called concurrent audit) useful in monitoring sick industrial units and to help the units in their rehabilitation.

Thus, it can be said that Management Audit can be a potential tool for managerial control & reduction of cost.

Q6. Write Short Notes on :

- (i) Energy Conservation**
- (ii) SWOT Analysis**
- (iii) Qualities and function of a Management Auditor**
- (iv) Causes and Symptoms for Industrial Sickness**
- (v) Management Audit Programme /MAP**
- (vi) Management Frauds**
- (vii) Audit Committee**

Answer 6.

(i) Energy Conservation :

Energy Conservation refers to optimum use of energy or getting the maximum production for every unit of energy conservation, which means improving its productivity and its optimum use.

1. Identifying the variable and fixed element of energy.
2. Identifying the cost centres which consumes 80% of each type of energy.
3. Comparative energy efficiency of similar machine.
4. Relationship between setup time and energy consumed.
5. Investment and time required for alternative energy sources.
6. Investment justification in case of under taking new projects for alternate sources.
7. Input-output study of energy.

(ii) SWOT Analysis :

SWOT analysis refers to the identification of a company's Strength, Weakness, Opportunities and Threats. While the first two are internal to the organization, the other two are external environment.

The following is an indicative list of questions for which answers must be obtained to make an objective SWOT analysis as follows :

1. Strength/ Weakness :
 - a. Financial
 - b. Marketing
 - c. Personnel
2. Opportunities / Threats
 - a. Power requirement and availability
 - b. International competition
 - c. Product obsolescence
 - d. Export potential
 - e. Opportunities available in the country
 - f. Government policy regarding the industry

(iii) Qualities and function of a Management Auditor :

Qualities :

The most important and essential qualities for a Management Auditor are :

1. Ability to grasp the business problems.
2. General understanding of the motive, purpose and objectives of the organization to be audited.
3. Knowledge about the basic management principles and practices.
4. Sufficient knowledge about Engineering, Statistical techniques, Cost and Management Accountancy, Production planning and control.
5. General understanding of various laws like Company Law, Customs, Central Excise, Income Tax, MRTP, FEMA etc.
6. Ability to prepare reports for different levels of management.
7. Ability to move and get along with all people at different levels.
8. Effective communicator with ability to elicit information.

Functions of a Management Auditor :

1. He should ensure that all pertinent information needed for planning reaches the higher management.
2. He should ensure that the decisions are based on the objectives of the management.
3. He should focus maximum attention of functions/ operations, which are profit making/ revenue yielding.
4. He should keep abreast with the developments taking place in Information Technology and introduce latest methods of information and communication systems – consistent with cost benefit studies needed to improve the systems.
5. The implication of changes in the budgetary proposals should be projected by him adequately both in respect of direct taxation.
6. Assist the management in achieving the most efficient and effective administration.

(iv) Causes and Symptoms for Industrial Sickness :

A company is declared as a sick industrial company if it incurs cash losses continuously for three years.

Some of the major causes and symptoms of sickness are as follows :

A. Internal Causes :

- a. Inadequate technical know-how /outdated production process.
- b. High cost of inputs.
- c. Over estimation of demand for the product / under estimation of requirement of working capital.
- d. Dependence on a single or a small number of customers.
- e. Defective pricing policy.
- f. Diversion of funds.
- g. Incompetent / dishonest management.

B. External causes :

- a. Product obsolescence.
- b. Infrastructure bottlenecks/ chronic power shortage.
- c. Natural calamities/ political uncertainties.
- d. Sudden changes in government policies.

C. Symptoms of sickness :

- a. Low capacity utilization.
- b. Larger and longer outstanding.
- c. Default in payment of statutory liabilities.
- d. Continuous irregularity in cash credit account.
- e. Diversion of working capital funds.

(v) Management Audit Programme /MAP :

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

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

An efficient management audit programme shall comprise the following:

- (i) Review of the organizational objectives and plans
- (ii) Study of the policies and practices of the management
- (iii) A critical review of the organizational structure
- (iv) Study of the systems and procedures
- (v) Evaluation of operations
- (vi) Study of the efficiency of the use of physical resources available
- (vii) Exercise of proper management control
- (viii) Maintain suitable monitoring system through management information system (MIS)
- (ix) Check on adherence to the statutory obligation and
- (x) Above all, review the efficiency of manpower handling, which ultimately results in the organization's success.

An audit programme is laying down the path in its required details before conducting such audit.

A management auditor shall shrewdly assess weak and risk areas in the organization and deal with such areas in more detail. He has to lay down a programme by making a list of such weak and risk areas and follow them up in his audit.

(vi) Management Frauds :

Fraud is an intentional misrepresentation of facts. In general, it is seen that top executives like Managing Directors, Directors, General Managers and other such executives occupying the positions in an organization are found to commit Management Frauds. These frauds are the deception practiced by these managers so as to show their performance better than what actually they are.

The manager / top executives for their personal benefit may commit of their fiduciary position and having easy access to the assets and greater power to control accounting and financial statement preparation, the managers/ top executives have better opportunities to defraud the company and others. Such frauds may take the form of misappropriation of assets and manipulation of records.

(vii) Audit Committee :

Audit Committee is set up by the company and their details are as follows :

- a. The audit committee shall have minimum three members.
- b. The chairman of the committee shall be an independent director.
- c. The chairman of the committee shall be present at Annual General Meeting to answer share holder's queries.
- d. The company secretary shall act as the secretary of the committee.

- e. The audit committee shall meet at least thrice a year.
- f. The audit committee shall have powers as follows :
 - 1. To investigate any activity.
 - 2. To seek information from an employee.
 - 3. To obtain outside legal or other professional advice.

Q7. Write in Brief:

- a. CERA-Audit of C and AG
- b. Valuation Audit
- c. Cenvat credit audit
- d. VAT Audit
- e. Environment Audit

Answer 7.**a. CERA-Audit of C and AG :**

Comptroller and Auditor General of India also carry out audits of all assessees. These are called 'CERA' i.e. Central Revenue Audit. These audit parties audit accounts of excise as well as customs assessees. C&AG Audit Report shall be submitted to President of India, who causes these to be laid before each House of Parliament. CERA audits are conducted as a part of audit of Government accounts. Thus, these audits are conducted under Constitutional authority and are in no way connected or related to internal audits carried out by the staff of excise department. Frequency of CERA Audits is as per the importance attached and availability of time to CERA audit parties.

b. Valuation Audit :

Valuation is one of the most vital and critical aspects of assessment of excise duty payable. In order to ensure that duty is being paid correct 'Assessable Value', a provision has been made to order a 'Special Audit' in some specified cases vide section 14A of CEA. The audit can be ordered only with prior approval of Chief Commissioner of Central Excise. Valuation Audit under section 14A can be ordered at any stage of enquiry, investigation or any proceedings before Assistant/Deputy Commissioner regarding assessable value of the goods manufactured by assessee, if the Assistant/Deputy Commissioner is of the opinion that the value has not been correctly declared by a manufacturer or any person. It may be noted that under rule 173C(3), 'enquiry' in respect of 'value' can be made as soon as Invoice is raised or 'Declaration regarding Assessable Value' is filed with Assistant/Deputy Commissioner. The special audit for valuation can be ordered by Dy./Asst. Commissioner with prior approval of Chief Commissioner.

c. Cenvat credit audit :

As per section 14AA of CEA (added w.e.f. 14th May, 1977), special audit of Cenvat credit availed or utilized can be ordered by Commissioner of Central Excise. Such audit can be ordered if the Commissioner of CE has reasons to believe that

- (a) Cenvat credit availed or utilized is not within the normal limits, having regard to nature of final products and type of inputs,
- (b) Cenvat credit has been availed or utilized by reason of fraud, collusion or any willful misstatement or suppression facts.

Such audit can be done by practicing 'Cost Accountant', to be appointed by Commissioner of CE. Expenses of and incidental to such audit, including the remuneration payable to the cost accountant shall be paid by Central Government (i.e. excise department). Audit of Cenvat credit availed or utilized by a manufacturer can be ordered under section 14AA if Commissioner has 'reason to believe' that Cenvat credit availed is not normal or the credit has been availed on account of fraud, willful misstatement, suppression of facts or collusion.

d. VAT Audit :

India has introduced Value Added Tax (VAT) system of taxation w.e.f. 1st April, 2005 joining the globally recognized sales taxation system that has been adopted by more than 130 countries.

This introduction of VAT in the country is considered as one the major reforms in the area of public finances since independence. The basic advantages of Value Added Tax can be stated as its neutrality, transparency, certainty and self policing mechanism. This is projected to make accounting more transparent, cut trade barriers, boost tax revenues and reduce tax evasion. VAT has replaced the single point sales tax system, which had number of disadvantages, primarily that of double taxation. VAT is a modern and progressive taxation multi point sales tax system that avoids double taxation, besides set off of tax paid on purchases. VAT has following advantages:-

- (a) It is a self policing and self assessment taxation system, which puts more trust on dealers;
- (b) It eliminates the cascading impact of double taxation and thus promotes economic efficiency;
- (c) It is invoice based and thus offers a better financial system with less scope for error;
- (d) It widens the tax base and promotes equity;
- (e) It has an improved central mechanism resulting in better compliance.

VAT is levied on sale of goods including intangible goods. The term "Goods" including every kind of movable property including goods of incorporeal and intangible nature subject to certain exclusions. All business engaged in the buying and selling of goods within the scope of VAT laws are referred to as dealers. The VAT system embraces all the businesses in the production and supply chain, from manufacture through to retail. VAT is collected at each stage in the chain when value is added to goods. It applies to all business, including manufacturers, distributors, wholesalers, retailers, works, contractors and lessors. However, VAT law specifically excludes all importers, exports and inter-state transactions, which are covered by the CST Act.

Generally, most of the items are covered under two main tax rates of VAT i.e. 4% and 12.5%. However, there are other separate rates also for luxury items or essential items. Moreover actual rates of tax on each item may vary in each state. The VAT is levied as a percentage of the price of each taxable sale transaction by the sellers. These sellers or dealers in turn, are reimbursed the amount of VAT paid by them on their purchases at the time of their sales in such a way that the actual amount of VAT is payable only on the incremental value added to the goods at each stage of production. Therefore, it is basically a tax on the value addition on the product and ultimately the burden of tax is to be borne by the consumer of goods.

e. Environment Audit :

The 'environmental audit' is an initial step towards the pursuit of environmental quality management. This environment audit makes the organization self-regulating. Moreover undertaking of 'environmental audit' on regular basis provides a platform for improvement aiming at "zero spills, zero pollution, zero waste and zero accidents".

Environmental audit is nowadays absolutely necessary for the survival of the industry and the economy to serve the best interest of the society at large. It is a systematic, documented, periodic and objective review by regulated entities, of facility operations and practice related to meeting environmental requirements. The objectives of an environment audit are –

- (i) to ensure cost effectiveness compliance with the statutes and company policies
- (ii) cost savings from improved practices
- (iii) to prepare data-base relating to pollution potential of all facilities
- (iv) to make a social cost-benefit analysis
- (v) to develop social reputation, confidence of customers
- (vi) to develop overall awareness, identifying problems and areas of risk
- (vii) to encourage the use of low waste technologies and prudent use of resources and to identify potential hazards and risks.

Environment audit has the following aspects –

- (i) Technological and operational aspect involving audit of the technology of environment management as well as the operation of environment management system.
- (ii) Environment valuation and environment costing without which environment management plans and policy implementation becomes useless and non-viable.

Thus in the absence of such environment valuation and environment costing, the cost of environment damage cannot be assessed for determination of compensation. In brief we can point out that no effective Environment Regulatory policies and measures can be formulated and implemented without proper environment valuation/costing.

Q8. EA 2000 (Excise Audit) is a modern, transparent and interactive method of audit. Do you agree? What is the scope for Cost Accountant in EA 2000 ?

Answer 8.

Central Excise Authorities have dispensed with all statutory records as a measure of simplification of procedures. Therefore assesses are not required to maintain the record of each receipt of raw material, production and clearance/sale of finished goods etc. in the registers/documents earlier prescribed by the Central Excise Department. Assessors are now allowed to maintain all their records in whichever form they like (including maintenance of the entire records in electronic form) provided the essential information required for calculation of central excise duty liability can be obtained from such records. Therefore, it becomes necessary for the auditors to look into the assessors records to verify whether the assessee is paying central excise duty correctly and following the laid down procedures.

So a need was felt for a change of approach in Excise Audit. Efforts should be to have a more effective system of audit to encourage greater compliance rate and more revenue. Moreover, it was also felt that Self Assessment has shifted the focus of departmental checks from pre-clearance to post clearance. Therefore, a strong and professional audit system based on basic accounting/auditing principles was envisaged to balance the twin objectives of safeguarding revenue and transparency.

In view of above, a new system of audit i.e. Excise Audit 2000 (EA 2000) was initiated from 1st December 1999. Excise Audit 2000 is the audit based on the scrutiny of business records of the assessee. This is a more systematic form of audit, wherein the auditors are required to gather basic information about the assessee and analyze them to find out vulnerable areas before conducting the actual audit. The audit is therefore more focused and in-depth as compared to the traditional audit. Further, at every stage of audit, the assessee is consulted. This makes EA 2000 audit user friendly.

The process of EA 2000 begins with identification of a unit to be audited. About 300 to 400 units are selected for conducting audit during a financial year based upon the manpower availability. The units were picked up for audit randomly under the conventional system without any scientific basis of selection. Under EA 2000, the selection of the unit is based on taking into account in the 'risk-factors'. The assesses, who have a bad track record (having past duty evasion cases, major audit objections, past duty dues etc.) are given priority for conducting audit over those having clean track record.

The auditors are required to gather as much information about the assessee as possible. They can gather information from the departmental records, published documents like balance sheets annual statements etc., and through market Enquirer. Since this can be done without interacting with the assessee, this step called as 'desk-review'. The department has now decided to use the expertise of Chartered/Cost Accountants during this process of desk review and has issued guidelines for selection of cases for Desk review by Chartered Accountants/Cost Accountants. At this stage of 'Desk Review', the auditors may have already identified certain areas which warrant closer examination from the assessee to complete his preliminary investigation. For this he may write letter to the assessee or send him a questionnaire to obtain this information. This step is called 'gathering and documenting assessee information'. The auditor then visits the unit of the assessee to see the actual running of the unit, the systems that are followed for maintaining records in various sections and the system of movement of goods and the related documents within the unit. This step is called 'touring of the premises'.

The next step is the conduct of actual audit, which in technical parlance is called 'Verification'. The auditors visit the unit of the assessee on a scheduled date (informed to the assessee in advance) and carry out the scrutiny of the records of the assessee as per the audit plan. The auditor is required to compare the documentation of a fact from different documents. For example, the auditor may check the figures of clearance of finished goods showed by the assessee in central excise return with the sales figures of the said goods in Balance Sheet, Sales Tax Returns, Bank statements etc. The auditor may also enquire about the entries which appear vague (say an entry like 'Misc. Income') in various records and documents. The process of verification is always carried out in presence of the assessee so that he can clarify the doubts and provide required information to the auditor.

A 'Draft Audit Report' is prepared at the end of the verification stage. An audit report provides (issue or para wise) the issue in brief, the reply or the explanation of the assessee, the reason for the auditor not being satisfied with the reply, the amount of short payment (if tabulated) and the recoveries of the same (if could be made at the spot). The draft audit report is then reviewed by the senior officers to ensure the sustainability of the objections raised by the auditors. The audit report becomes final after such review and in cases where the disputed amounts have not already been paid by the assessee at the spot, demand notices are issued by the department for their recoveries.

Q9. (a) Explain the major changes brought by Sarbanes Oxley Act in the area of Corporate Governance.**Answer 9.(a)**

Sarbanes-Oxley Act of 2002 is also known as the Public Company Accounting Reform and Investor Protection Act of 2002 and commonly called SOX or Sarbox. This is a United States federal law enacted on July 30, 2002 in response to a number of major corporate and accounting scandals including those affecting Enron, Tyco International, Adelphia, Peregrine Systems and WorldCom. The legislation establishes new or enhanced standards for all U.S. public company boards, management and public accounting firms. However, it does not apply to privately held companies.

The Act contains 11 titles or sections ranging from additional Corporate Board responsibilities to criminal penalties. The Act also establishes a new quasi-public agency, the Public Company Accounting Oversight Board, or PCAOB, which is charged with overseeing, regulating, inspecting, and disciplining accounting firms in their roles as auditors of public companies. The Act also covers issues such as auditor independence, corporate governance, internal control assessment, and enhanced financial disclosure. Each title consists of several sections summarized as under:

(a) Public Company Accounting Oversight Board (PCAOB) :

Title I establishes the Public Company Accounting Oversight Board to provide independent oversight of public accounting firms providing audit services. It also creates a central oversight board with responsibility for registering auditors, defining the specific processes and procedures for compliance audits, inspecting and policing conduct and quality control, and enforcing compliance with the specific mandates of SOX.

(b) Auditor Independence :

Title II establishes standards for external auditor independence aimed at limiting conflicts of interest. It also addresses the issues like approval requirements for new auditor, policy for audit partner rotation, conflict of interest issues and auditor reporting requirements. Section 201 of this title prohibits any public accounting firm from providing non-audit services to a firm while auditing the same firm. These services include book-keeping, appraisal, and others (excludes tax preparation). Section 203 of this title mandates that the lead auditor and reviewing partner must rotate off the audit every 5 years. Section 204 of this title further requires that Auditors must report all critical accounting policies and practices to the firm's audit committee.

(c) Corporate Responsibility :

Title III mandates that senior executives shall be individually responsible for the accuracy and completeness of corporate financial reports. It provides for the interaction of external auditors and corporate audit committees and the responsibility of corporate officers for the accuracy and validity of corporate financial reports. It enumerates specific limits on the behaviours of corporate officers and penalties for non-compliance. For example, Section 301 calls for the formation of an independent and competent audit committee. The audit committee is responsible for hiring, setting compensation and supervising the auditor's activities. SOX requires that each member of a firm's audit committee be a member of the board of directors and be "independent". The term "independent" means the members are neither part of the management team nor do they perform any consulting or professional services for the firm. Moreover, it is also recommended that each audit committee have a "financial expert" as part of the committee. Section 302 requires the CEO and chief financial officers to certify that the financial statements accurately and fairly represent the financial condition and operations of the company. There are criminal sanctions for intentional

false certification. The signing officers must certify that they are "responsible for establishing and maintaining internal controls" and "have designed such internal controls to ensure that material information relating to the company and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared."

(d) Enhanced Financial Disclosures :

Title IV provides for the enhanced reporting requirements for financial transactions including off-balance-sheet transactions, pro-forma figures and stock transactions of corporate officers. It requires internal controls for ensuring the accuracy of financial reports and disclosures and mandates both audits and reports on those controls. The most contentious aspect of SOX is Section 404, which requires management and the external auditor to report on the adequacy of the company's internal control over financial reporting (ICFR). This is the most costly aspect of the legislation for companies to implement, as documenting and testing important financial manual and automated controls requires enormous effort. Section 404 requires that each annual report should contain an internal control report. This report provides for the responsibility of management to establish and implement adequate procedures for financial reporting. This report must include the assessment of effectiveness of internal control structure and procedures, any code of ethics and contents of that code.

(e) Analyst Conflicts of Interest :

Title V includes measures, which are aimed at restoring investor confidence in the reporting of securities analysts. It defines the codes of conduct for securities analysts and requires disclosure of knowable conflicts of interest.

(f) Commission Resources and Authority :

Title VI defines practices to restore investor confidence in securities analysts. It also defines the SEC's authority to censure or bar securities professionals from practice and defines conditions under which a person can be barred from practicing as a broker, adviser or dealer.

(g) Studies and Reports :

Title VII is concerned with conducting research for enforcing actions against violations by the SEC registrants (companies) and auditors. Studies and reports include the effects of consolidation of public accounting firms, the role of credit rating agencies in the operation of securities markets, securities violations and enforcement actions.

(h) Corporate and Criminal Fraud Accountability :

Title VIII is also referred to as the "Corporate and Criminal Fraud Act of 2002". SOX provide new protection for whistle blowers and mandates criminal penalties for actions taken against whistle-blowers. It is now illegal for any (includes private firms) firm to punish whistleblowers in any way. This portion of the SOX is especially important for co-op boards to follow as a best practice. All organizations should implement procedures for handling employee complaints referring to accounting or financial management practices. It is recommended that organizations should establish an anonymous complaint process to encourage employees to report any inappropriate financial management practices.

(i) White Collar Crime Penalty Enhancement :

Title IX is also called the “White Collar Crime Penalty Enhancement Act of 2002.” This section increases the criminal penalties associated with white-collar crimes and conspiracies. It recommends stronger sentencing guidelines and specifically adds failure to certify corporate financial reports as a criminal offense.

(j) Corporate Tax Returns :

Title X includes Section 1001, which provides that the Chief Executive Officer should sign the company tax return.

(k) Corporate Fraud Accountability :

Title XI includes Section 1101, which recommends a name for this title as “Corporate Fraud Accountability Act of 2002”. It identifies corporate fraud and records tampering as criminal offenses and joins those offenses to specific penalties. It also revises sentencing guidelines and strengthens their penalties. This enables the SEC to temporarily freeze large or unusual payments.

Q.9. (b) What is Energy Audit & how is it linked to Environment Audit?

Answer 9. (b)

An Energy Audit has been defined as an inspection, survey and analysis of energy flows in a building, process or system with the objective of instituting energy efficiency programs in an establishment. It consists of activities that seek to identify conservation opportunities preliminary to the development of an energy savings program. In other words, an energy audit is conducted to seek opportunities to reduce the amount of energy input into the system without negatively affecting the output(s). An energy audit also seeks to prioritize the energy uses according to the greatest to least cost effective opportunities for energy savings. In simple words, Energy audit means monitoring the energy efficiency of different equipment and process in a plant and looking into way by which the total sum of energy consumed can be cut down without affecting production or its efficiency.

In view of above, an energy audit is a fundamental step of the energy conservation programme in any industrial plant or energy consuming facility. Energy utilization and conservation play an important role in an industry in the current scenario of rapidly diminishing fossil fuels, explosive rise in the prices of crude oil and other energy sources and a possible switch over to alternative source of energy both for conserving energy costs and towards attempt for alternative sources of energy.

Energy audit and environment audit sometimes done together as both involve measurement of same parameters i.e., which are common to both. Thus for a boiler, for example, both would require measurement of fuel flow and air flow, CO₂ in the flue gas, etc. The energy-cum-environment audit allows a simultaneous consideration of energy and environmental aspects. As a result, it is possible to identify options to reduce the overall cost of energy as well as pollution control. Moreover, some of the principles of energy cost reduction and pollution control are also identical. Thus, an energy-cum-environment audit would eliminate the repetitive measurement of these common parameters. An energy-cum-environment audit is an analogous step of a programme aimed at conserving energy in an energy consuming facility and keeping its impacts on the environment within acceptable limits.

Q10. Enumerate ten statutory and specific fields of audit, verification and certification open to Cost Accountants in practice other than Cost Audit.

Answer 10.

The statutory and specific fields of audit open to Cost Accountants in practice are:

- (i) Cost Audit under Section 233B of the Companies Act, 1956.
- (ii) Central Excise Audit under Section 14A of Central Excise Act, 1944 and Central Excise Special Audit under Section 14AA of the Central Excise Act, 1944
- (iii) Inventory Audit
- (iv) Concurrent Audits in Banks
- (v) Sales Tax / VAT Audit
- (vi) Telecom Regulatory Authority of India (TRAI) Audit
- (vii) Special Audit under Customs Act
- (viii) Management and Operational Audit etc.
- (ix) Service Tax Audit
- (x) Anti-Dumping

Q11. What do you understand by “Anti-dumping duty”? Briefly explain the provisions in the Cost Accounting Records Rules and Cost Audit (Report) Rules covering this aspect.

Answer 11.

When a product or commodity is exported at a price which is lower than its cost of production in the exporting country, it is treated as “Dumping”. As this practice affects the competitiveness of manufacturers/ producers of that product/ commodity in the importing country, the Government of that country usually, in order to protect the interests of those producers, levy additional import duty which is called “Antidumping Duty”. The WTO under GATT’94, has laid down the norms and criteria for levy of such duties.

As this exercise calls for detailed analysis and verification of the cost of production, the Cost Accounting Record Rules prescribed during the last few years provide for maintenance of proper records – whenever WTO provisions are attracted to identify the competitiveness of the product in the domestic as well as global market, and the expenses, if any, incurred to combat the competition arising out of WTO provisions. Adequate statistical records shall also be maintained to identify the market share of the product manufactured and the likely impact thereon on account of competitive goods imported into the company. These records shall indicate, inter alia, the total volume of imports, names of importers, countries of origin and contain such empirical evidence as to show whether such imports can be construed as dumping and affecting the market share of the product. Proper records shall also be maintained containing such details as may be necessary to show that the export price of the product is not such as to be construed as dumping in the importing country, by applying the provisions of WTO regarding antidumping measures under Article VI of GATT’94.

The Cost Audit (Report) Rules, 2001, calls for the Auditor's observations/ suggestions on steps required strengthen the company under the competitive environment especially with regard to need for protection from chapter imports, if any. For this purpose, the company is required to provide data in Para 22 of the Annexure to the Cost Audit Report.

Q12. Explain whether the following activities amount to professional misconduct:

- a. A Cost Accountant takes voluntary retirement from his employer and starts practice. He continues his association with his previous employers as an advisor, on a monthly retainer.**
- b. A practicing lawyer specializing in anticipating cases comes to an informal understanding with an independent practicing Cost Accountant to assist him in preparing accounting statements to support his cases and agrees to share his fees on a percentage basis.**
- c. A Cost Accountant gives a certificate of cost for a product manufactured by an SSI Unit owned entirely by his son.**

Answer 12.

- (a) As the accountant has severed his connection with his previous employer as an employee and acts only in an advisory capacity, which is a legitimate activity of a practicing cost accountant, it does not amount to misconduct.
- (b) Although the practicing cost accountant can accept the assignment for preparing the necessary statements for the antidumping cases for a specified fee, the sharing of total fees on a percentage basis between the lawyer and cost accountant amounts to an informal partnership between them, which is prohibited. Therefore, this practice falls under the definition of misconduct.
- (c) The Second Schedule to the Cost and Works Accountants Act, 1959 stipulates that a Cost Accountant in practice shall be deemed to be guilty of professional misconduct if he expresses his opinion on cost or pricing statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest, unless he discloses the interest also in his report. Strictly speaking, a cost accountant issuing a certificate for a unit in which he has no direct interest is in order. However, as in this case the factory is owned by the cost accountant's son it would be prudent on the part of the accountant to desist from issuing such a certificate on moral grounds.

Q13. Discuss the provisions of professional misconduct in relation to Cost Accountant in practice as a part of the "First Schedule" to the Cost and Works Accountants Act, 1959.

Answer 13.

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

- (i) allows any person to practice in his name as a cost accountant unless such person is also a cost accountant in practice and is in partnership with or employed by him;
- (ii) pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Explanation – In this item, “partner” includes a person residing outside India with whom a cost accountant in practice has entered into partnership which is not in contravention of item (4) of this Part;

- (iii) accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute;

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share, commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (2) of this Part;

- (iv) enters into partnership, in or outside India, with any person other than a cost accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (iv) of sub-section (1) of Section 4 or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships;
- (v) secures, either through the services of a person who is not an employee of such cost accountant or who is not his partner or by means which are not open to a cost accountant, any professional business:

Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of items (2), (3) and (4) of this Part;

- (vi) solicits clients or professional work, either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means:

Provided that nothing herein contained shall be construed as preventing or prohibiting –

- (a) any cost accountant from applying or requesting for or inviting or securing professional work from another cost accountant in practice;
- (b) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;

- (vii) advertises his professional attainments or services, or uses any designation or expressions other than cost accountant on professional documents, visiting cards, letter heads or sign boards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the Institute of Cost Accountants of India or of any other institution that has been recognised by the Central Government or may be recognised by the Council:

Provided that a member in practice may advertise through a write up, setting out the services provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council;

- (viii) accepts a position as cost accountant previously held by another cost accountant in practice without first communicating with him in writing;
- (ix) charges or offers to charge, accepts or offers to accept in respect of any professional employment, fees which are based on a percentage of profits or which are contingent upon the findings or results of such employment, except as permitted under any regulation made under this Act;

- (x) engages in any business or occupation other than the profession of cost accountant unless permitted by the Council so to engage:

Provided that nothing contained herein shall disentitle a cost accountant from being a director of a company (not being a managing director or a whole-time director) unless he or any of his partners is interested in such company as accountant;

- (xi) allows a person not being a member of the Institute in practice, or a member not being his partner to sign on his behalf or on behalf of his firm, any cost or pricing statements or any other statements relating thereto.

Q14. There are certain acts or omissions for which a Cost Accountant in practice would be liable to professional misconduct including action by a High Court. What are those acts or omissions?

Answer 14.

A cost accountant in practice is one who is holding a certificate of practice under Sections 6 and 7 of the Cost and Works Accountants Act, 1959. If a person desires to practice as a Cost Accountant, he should apply to the Council of the Institute of Cost and Works Accountants of India in proper form and obtain a certificate of practice.

Each and every member of the profession in practice is required to follow certain professional ethics and code of conduct as prescribed by the Cost and Works Accountants Act, 1959 and regulations thereunder. Section 22 of the Cost and Works Accountants Act, 1959 defines that "professional or other misconduct" is deemed to include any act or omission provided in any of the Schedules but nothing in this section shall be construed to limit or abridge in any way the power conferred or duty cast on the Director (Discipline) under Section (1) of section 21 to enquire into the conduct of any member of the Institute under any other circumstances.

This definition under Section 22 of the Cost and Works Accountants Act, 1959 read with the two schedules to the Act clarifies or indicates that the schedules provide an illustrative list of acts and omissions constituting "professional or other misconduct" as Director (Discipline) is competent to enquire into the conduct of any member of the Institute under any other circumstances.

Similarly Para 2 of Para IV of the First Schedule provides that a member of the institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if in the opinion of the council he brings disrepute to the profession or the institute as a result of his action whether or not related to his professional work. In view of above, it is clear that the definition of misconduct is very wide and should be adhered in letter and spirit. The Acts or omissions constituting professional misconduct as defined in Section 22 are detailed in two schedules of the Act. The First Schedule is divided into the following four parts:

Part-I - Professional Misconduct in relation to Cost Accountants in practice;

Part-II - Professional Misconduct in relation to Members of the Institute in Service;

Part III - Professional Misconduct in relation to Members of the Institute Generally; and

Part IV - Other Misconduct in relation to Members of the Institute Generally.

The Second Schedule requiring action by the Disciplinary Committee is divided into the following two parts:

Part-I - Professional Misconduct in relation to Cost Accountants in practice;

Part-II - Professional Misconduct in relation to Members of the Institute generally.

In addition to above, Para 1 of Part-II of the Second Schedule provides that a member of the institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made there-under or any guidelines issued by the council. Reference is also drawn to Cost Accounting Standards (CAS) issued by the Cost Accounting Standard Board of the ICWAI. These CAS are recommendatory in nature by the Council of ICWAI and every member of the Institute is expected to honour the same (Para 5 of the Preface to Cost Accounting Standard Board). Para 5.8 of the preface further provides that Cost Auditors will adopt and encourage the adoption of the standards, wherever applicable, in maintenance of Cost Accounting Records Rules under section 209(1) (d) and report the deviations, if any, in the Cost Audit Reports u/s 233B. Para 6.3 provides that disciplinary restriction may be imposed by the Council of the Institute at appropriate stages as may be felt necessary for not complying with or not honouring the standard. In view of above, it is clear that non-compliance of non-honouring of Cost Accounting Standards may also be termed as misconduct.

Q15. The Managing Director of a company has called you in to look at the Management Information System (MIS) in his company. He complains that every month he receives a tonne of computer printouts but does not get what he wants. Would you go about carrying out an audit of the company's MIS? Start form stating the features of a good MIS and proceed to examine the changes needed.

Answer 15.

Using the computer for audition there is no doubt that computer obviates several intermediate printouts and the hidden records in the magnetic media could be problems for the auditor not adequately trained in computer data processing, but the very facts that records are in a machine readable form suggests possibility for using the capabilities of the computer to assist the auditor in his burdensome task. This however requires that the cost auditor is sufficiently proficient in computer data processing and programming. Where the control in both data processing and user's department is adequately reliable. The stipulations of an audit may be dropped, and instead the cost auditor may comply special technique.

The cost auditor has to consider various aspects while evaluating the effectiveness of a Management Information System. At first he should consider the following aspects while appraising the MIS –

- (i) the content, quality and source of information
- (ii) flow of information from the originator to the receiver, and
- (iii) correlation of information in the decisional areas.

Contents and sources of information : This may include the following :

- (i) Whether the information collected is relevant to the decision problem or whether it will result in the improvement in the quality of decisions.

- (ii) Whether there is any tendency of the manager to use control data for postmortem exercise.
- (iii) Whether the reporting of MIS is regular and uniform for financial and non-financial information.
- (iv) Whether the information contain unwanted information.
- (v) Whether the MIS adequately caters to the requirements of decision makers.

Flow of information : A cost auditor has to proceed on the following lines :

- (i) System organization :
 - (a) system is centralized or decentralized,
 - (b) flow of information from various units to the control section,
 - (c) estimating the volume of data, transmission time and cost,
 - (d) cost-benefit analysis of centralized v. decentralized information.
- (ii) Data collection and management : Appraisal should include the following aspects:
 - (a) methodology of collecting data,
 - (b) whether the data is filtered and classified,
 - (c) whether the data is properly matched with decision problems,
 - (d) whether the management carried out detailed study regarding existing frequency,
 - (e) whether system design is free or any possible constraints.

Correlation of MIS with the decision areas : Cost auditor should examine this aspect from the following angles:

- (i) Whether input-output analysis is attempted.
- (ii) Whether MIS is helpful in reducing the effects of uncertainty.
- (iii) Whether MIS is cost-effective.
- (iv) Whether the information is being supplied to the users very effectively.
- (v) Whether MIS is providing a feedback for corrective action, and
- (vi) Whether MIS is able to optimize the value of information?

Q16. Write in brief on:

- (a) CAAB (The Cost Audit & Assurance Standard Board)
- (b) QRB (Quality Review Board)
- (c) ICWAI as IFAC Member

Answer 16.

(a) CAAB (The Cost Audit & Assurance Standard Board) :

The Institute of Cost and Works Accountants of India (ICWAI) is committed to the goal of enabling the cost and management accounting profession in India to provide services of high quality in the public interest as per the international standards. ICWAI has developed and promulgated technical standards and other professional literature to realize this goal. The ICWAI being one of the founder members of the IFAC, the standards are being developed and promulgated by the Cost Audit & Assurance Board (CAAB) under the authority of the council of

ICWAI are in conformity with the corresponding International Standards issued by the International Auditing and Assurance Standards Board (IAASB), established by IFAC.

The primary objectives of CAAB may be summarized as follows:

- To identify the areas in which Standards on Quality Control and Engagement Standards are required to be developed after reviewing the existing and emerging audit practices worldwide;
- To serve the public interest by formulating and setting high-quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the auditing and assurance profession.
- To demonstrate to the regulators, investors, business community, interested third parties and the wider public about commitment to upholding and developing professional standards that command public confidence and to provide comfort and assurance to users of financial statements, regulators and third parties.
- To establish appropriate quality assurance standards and guidelines in relation to audit practice of the firms that are considered essential in the interest of the profession, in the public interest and to comply with the requirements of ICWAI's professional requirements as well as Statements of Membership Obligation (SMO)-I on Quality Assurance issued by the International Federation of Accountants (IFAC). The SMOs clarify and strengthen IFAC's membership obligations and seek to enhance the performance of accountants worldwide,
- To provide support and guidance to help audit firms to develop and improve their practices,
- To take up a program of practice review which applies to all practicing members in India who hold a Certificate of Practice (COP) of ICWAI.

(b) QRB :

As already stated above, there has been growing demand for high quality assurance, consistency and greater transparency in the functioning of profession. A need for over sight board was being felt, which would contribute to public confidence in the integrity and enhancing the quality of work done by the members of the Institute. Therefore provision of a "Quality Review Board" has been incorporated into the Cost and Works Accountant Act 1959 to review the quality of services provided by the Cost Accountants and making recommendations for improvement. Section 29A of the Cost and Works Accountants Act 1959 provides for establishment of 'Quality Review Board' consisting of a chairperson and four other members. Out of there four members of the Board, two members shall be nominated by the council and other two members shall be nominated by the Central Government. Section 29-B of the Act relates to the functions of the Board. It provides that the Board shall perform the following functions:

- (i) to make recommendations to the council with regard to the quality of services provided by the members of the Institute;
- (ii) to guide the members of the institute to improve the quality of services, provided by the members of the institute including cost adviser services; and

- (iii) To review the quality of services and adherence to the various statutory and other regulatory requirements.

This constitution of 'Quality Review Board' is therefore, aimed at maintenance as well as enhancement of quality of attestation services or cost audit services and to provide guidance to members to improve their performance and adhere to various statutory and regulatory requirements. The quality review process is mainly focused on:

- Compliance with technical standards
- Quality of reporting
- Office system and procedures
- Training programmes for staff concerned including appropriate infrastructure.

(c) ICWAI as IFAC Member :

The Institute of Cost and Works Accountants of India is one of the founder members of the International Federation of Accountants (IFAC). The mission of the IFAC is "the worldwide development and enhancement of an accountancy profession with harmonized standards, able to provide services of consistently high quality in the public interest. "In pursuing this mission, the IFAC Board has established the International Auditing and Assurance Standards Board (IAASB) to develop and issue, in the public interest and under its own authority, high quality auditing and assurance standards for use around the world. The ICWAI being a member of the International Federation of Accountants (IFAC), the Auditing and Assurance Standards developed and promulgated by the ICWAI are required to be in harmony, to the extent possible in the light of the conditions prevailing in India, with the corresponding International Standards on Auditing, International Standards on Review Engagements, International Standards on Assurance Engagements, International Standards on Related Services or International Standards on Quality Control, issued by the International Auditing and Assurance Standards Board (IAASB) of the IFAC (Appendix – C). IFAC also issues policy positions on topics where the profession's expertise is most relevant.

IFAC has long recognized the need for a globally harmonized framework to meet the increasingly international demands that are placed on the accountancy profession. IFAC's standard-setting boards follow a due process that supports the development of high quality standards in the public interest in a transparent, efficient, and effective manner. These standard-setting boards all have Consultative Advisory Groups, which provide public interest perspectives and include public members. IFAC's Public Interest Activity Committees (PIACs) – the International Auditing and Assurance Standards Board, International Accounting Education Standards Board, International Ethics Standards Board for Accountants, and the Compliance Advisory Panel – are subject to oversight by the Public Interest Oversight Board (PIOB). IFAC has also issued Auditing and Assurance Standards, which are adopted by all the members institutes from different countries. IFAC regulations also require that the audit firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances. In view of the present day requirements for upholding the image and dignity of the profession as a whole and for more close monitoring of the quality control standards of its practicing members, The Institute, being a member body of the International Federation of Accountants (IFAC) and is committed to follow the international standards in addition to its own standards.

Q17. List the tasks that can be performed by a Cost and Management Accountant in practice in the following areas:

(a) Direct Tax Laws, (b) Central Excise, (c) Banks and Financial Institutions.

Answer 17.

(a) Direct Tax Laws : These include Income –Tax, Wealth Tax etc.

The scope of work available for a Cost Accountant in practice in this area could be –

- (i) Appearing before the Income-tax Authority or Appellate Tribunal as authorized representative of the assessee.
- (ii) In Wealth Tax, he can register himself as a certified valuer of stocks, shares, debentures, etc.

(b) Central Excise : A Cost Accountant can undertake -

- (i) Conduct Audit u/s 14(a) for Excise Tax/Duty
- (ii) He can certify figures of production for goods used for captive consumption u/s 4 of the Central Excise Act and Central Excise (Valuation Rules)
- (iii) He can provide guidance to the company in ascertaining the cost of production for goods used for captive consumption.
- (iv) He can undertake certification of deduction permitted from the invoice value to determine assessable value.
- (v) He can act as an authorized representative before the Customs, Excise and Gold Control Appellate Tribunal and other such authorities.

(c) Banks and Financial Institutions :

- (i) He is eligible for appointment as concurrent auditor for All India Financial Institutions and Nationalised Banks.
- (ii) He can assist in Bureau of Industrial and Financial Reconstruction (BIFR) matters.
- (iii) He is eligible for enlistment in the panel of consultants for All India Financial Institutions and Nationalised Banks.