

Cost Audit & Operation Audit or Cost Audit

1. Salient features of the "Cost Audit Report Rules, 2001" (highlighting the main differences over the Existing Provisions).

The following are some of the salient features of the Cost Audit Report Rules, 2001.

1. The Cost Audit Report is to be supplied in duplicate, as against the previous procedure of submission in Triplicate.
2. The Cost Audit Report should be placed before the Board of Directors of the Company.
3. The Cost Proforma and Annexure to the Cost Audit Report should be authenticated by the Company Secretary and a Director or by Two Directors. Further, the company should fill up 28 Paragraphs of the Annexure to Cost Audit Report and the Cost Proforma within 135 days from the close of the financial year as against the present time lag of 90 days.
4. The Cost Auditor should check all the information given by the Company within 45 days and submit the Cost Audit Report within 180 days of the close of the year.
5. The Form of the Cost Audit Report has been enlarged.
6. The opinion/suggestion of the Auditors contained in Para 14 of the old Report are now included in the main Format of the Cost Audit Certificate.
7. The Cost Auditor has a special responsibility on reporting "Related Party Transactions" and offer his comments on: (i) Pricing, (ii) Reasons for Loss, (iii) Calculation of BEP, etc.
8. Thus the position of Cost Auditor has been elevated as a true 'Watch Dog'.
9. The cost auditor will be required to offer specific comments on protection from cheaper imports and exports benefits availed by the company. Para No. 1 will give more statistical information than before like Date of Board of Directors approval of the Annexures to the Cost Audit Report, No. of Audit committee meetings held, Name Qualification and Designation of Head of Costing Department, etc.

2. (i) Why is Cost Audit Report not made public. Whether the Members of Parliament have access to the Cost Audit Report.
- (ii) A company, manufacturing Cotton Textiles, wrote off in the same year the expenditure in replacement of Copper Rollers used for Printing Fabrics and Stainless Steel Frames used for Dying Yarn. Whether the Cost Auditor can qualify the report for these.
- (iii) A person has been appointed as Cost Auditor for Twenty products manufactured in seven companies. He is again proposed for appointment as Cost Auditor for three more products manufactured by two other companies. Will this appointment be 'In Order'?
- (iv) A person is doing Internal Audit on one of the factories manufacturing 'Cement' in a company. He was proposed for appointment as Cost Auditor in another factory of the same company manufacturing cement for the same period. Is this appointment as Cost Auditor 'In Order'?
- (i) According to Cost Audit Report Rules, the cost auditor is required to submit the Cost Audit Report to the Central Government and a copy thereof to the company concerned. The shareholders/ the general public unlike Financial Audit report have no access to Cost Audit report. It is treated as a confidential document. Report contains Important confidential information which if divulged would affect the competitiveness in trade and business of a company whose information is divulged. It contains lots of information, viz.,
 - (a) A detailed note on the manufacturing process of the company.
 - (b) Quantities and rates of various items of input materials i.e., the entire recipe is given.
 - (c) Quantities and rates of utilities consumed
 - (d) Average Sales realization, discount allowed for each item of product and the Sales promotion expenses.
 - (e) Details of export market, quantity exported F.O.B. realization etc.
 - (f) Any other energy saving measure or technical improvement in process, which a company might have implemented, arising out of its own research.

Such data, as a measure of business strategy should not be made available to the competitors, who may take advantages and put the company to a disadvantageous position. Such positions of law imply that cost data is a secret matter and the company secrets and its management strategy contained therein should not be disclosed. Even though, there is a provision under subsection (10) of section 233-B of the Companies Act that the Central Government can direct a company to circulate the full or part of the Cost Audit Report to the Shareholders. This power has not been exercised so far.

It is for the same reason mentioned above that members of parliament are not allowed to access the Cost Audit Report. There have been several demands in parliament asking for vital information from Cost Audit Report. But since parliament has already made law under which Cost Audit Report is to be treated as a confidential document other than for Government and Board of Directors of the Company. Parliament was politely informed that unless the law is changed, member can not have access to the Cost Audit Report. But Government have agreed to give all non-confidential information like, overall profitability, capability, capacity utilization etc. from the Cost Audit Report.

As regards members of parliament (MPs), they are representatives of the public. In view of what has been stated in the Para above, there is no specific provision in the Companies Act or Cost Audit Report Rules to make the Cost Audit Report being made available to them.

- ii. The Cost Auditor is justified in qualifying his report because according to Cost Accounting Records (Textiles) Rules, cost of items like Copper Rollers used for printing fabrics and the stainless steel frames used for dying yarn put into use in the relevant year shall be treated as deferred revenue expenditure and

- spread over the effective life of such items. Thus writing off such items in the same year is not correct.
- iii. Under section 224(1-B) of the Companies Act, 1956 a person can be appointed as a Cost Auditor for 20 companies of which not more than 10 companies shall have a paid-up capital of Rs. 25 lakhs or more. In this case, a person has been appointed as Cost auditor only in seven companies and he has been proposed for appointment in two more companies thus making it to a total of nine companies. He is well within the limit of 20 or 10 companies, as the case may be, because the number of products has no relevance. It is only the number of companies, which has been specified in law and not the number of products.
 - iv. A Cost Auditor can be appointed separately for each factory. If a person is working as an Internal Auditor of one factory, there is no objection on the same person working as a Cost Auditor of another factory of the same company, even though both factories are manufacturing the same product.

3. Steps to be taken by a company from the time the Cost Audit is ordered for its product and the report are submitted by the Cost Auditor to the Government, Specifying the time schedules and penalties for noncompliance.

Steps to be taken by a company brought under Cost Audit for the first time:

- i. Shortlist a panel of Cost Accountants in practice and place before the Board of Directors for selection of a Cost Auditor.
- ii. Board to pass a resolution proposing the name of Cost Auditor and fixing his remuneration; prior to this, the company should obtain a certificate from the proposed Cost Auditor under section 224 (1-B) that he does not suffer from any disqualification and that the audit will be within the ceiling of number of audits prescribed.
- iii. Make an application in Form 23C to the Central Government seeking approval for appointment of the Cost Auditor, with the prescribed fee, within 45 days from the commencement of the accounting year for which approval is sought.
- iv. Approval of the Central Govt. will be communicated to the company, with copy to the Auditor.
- v. The company shall notify the Cost Auditor about his appointment.
- vi. The company shall periodically make available to the Cost Auditor the Cost Accounting Records prescribed under section 209 (1) (d), at least on a quarterly basis.
- vii. Within 115 days from the close of the accounting year, the company shall prepare the Annexure to the Cost Audit Report under the Cost Audit (Report) Rules, 2001, and place the same before the Board of Directors. The Annexures should be signed by the secretary of the company and one Director, and if there is no Secretary, by the Directors, and place it before the Auditor for audit.
- viii. The Cost Auditor shall within 180 days from the close of the accounting year, audit the Cost Accounting Records under section 209 (1) (d) and the Annexure to the Cost Audit Report and submit his Report to the Central Government with a copy to the company.

Penalties for Noncompliance: If the company contravenes the provisions of the Companies Act or the Cost Audit Report Rules, the Company and every officer thereof in default shall be punishable with fine which may extend to five thousand rupees, and where the contravention is a continuing one, with a further fine which may extend to five thousand rupees for every day during which such contravention continues.

If default is made by the Cost Auditor in complying with the provisions, he shall be punishable with fine which may extend to five thousand rupees.

4. "Anti-dumping duty"[the provisions in the Cost Accounting Records Rules and Cost Audit (Report) Rules covering this aspect]

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 W.T.O., 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 W.T.O. 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 W.T.O. 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 W.T.O. regarding antidumping measures under Articles VI of GATT'94.

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

5. Tasks that can be performed by a Cost and Management Accountant in practice in the following areas:

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

(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 authorised 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 authorised 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.

6. Structure of WTO and its functions. Provisions of Cost Accounting Records Rules relating to the impact of multilateral trade agreements.

The WTO has a three tier organizational structure.

1. The Ministerial conference is the highest body, and is composed of the representatives of all the members.

2. The General Council is an Executive Forum composed of representatives of members and discharges the functions of the MC during the intervals between the meetings of the MC which normally take place once into two years.

3. There are three functional councils under the General council -

(a) Council for trade in goods.

(b) Council for trade in service.

(c) Council for Trade related aspects of intellectual property rights.

The main functions of the WTO are :-

(a) Facilitating the management of multilateral and Plurilateral Trade Agreements.

(b) Acts as a forum for negotiation of the above agreements between members.

(c) Administration of the understanding on Rules and procedures governing settlement of disputes.

(d) Coordination with other wings of the UNO.

Some of the Cost Accounting Records Rules recently promulgated stipulate that wherever WTO provisions are attracted, proper records shall be maintained to identify the competitiveness of the product in the domestic and global markets. Proper records shall also be maintained to show that the export price is not such as to be construed as dumping in the importing country under Article VI of GATT 1994.

7. A BIFR company -a turn around package for the company -note to prepare a turn around plan.

Turnaround package preparation for the sick company.

The following steps will be there:-

i. Carry out a SWOT analysis.

ii. Identify causes for the sickness.

iii. Generate ways to build up on the strength and opportunities by discussions with the top level executives of the company and by brainstorming

iv. Examine and evaluate the ideas generated and determine priorities among them.

v. Discuss the proposals with all concerned and generate acceptability,

vi. Estimate the resources needed for the implementation.

vii. Draw up a time frame for the turnaround.

8. You will treat the following items in the Cost Accounting Records— (i) Interest received on security deposit with the Electricity Board, (ii) Commission paid to the Managing Director, as a percentage of profit, included in the financial accounts under the head 'Salaries and Wages', (iii) Voluntary Retirement Compensation paid to workers, included under 'Wages', (iv) 'CENVAT' availed as credit on purchased raw materials., (v) Profit on sale of fertilisers to cane-growers by a sugar company.

i. Interest on security deposit with the Electricity Board can be set off against interest paid or alternatively, it can be taken as a credit against overheads.

ii. This is clearly an item to be excluded from cost. This should be shown as an item in the reconciliation statement between Costing and Financial P&L accounts.

iii. This is a onetime nonrecurring expenditure. Even if it is included under 'Salaries and Wages' in Financial Accounts, it should be excluded for Cost Accounts purpose. This item is also is an item of reconciliation between Cost and Financial Accounts.

iv. This is to be deducted from the cost of raw materials, and only the net value should be taken in the priced stores ledger, which forms the basis for pricing material issues to cost centres.

- v. This is purely a trading activity. Hence profit derived from such activity should be shown as an item of reconciliation between Financial and Cost Accounts.

9. Certain requirements of audit based on principles of propriety are stipulated in the Cost Audit Report-meaning of propriety audit and the aspect covered by Cost Audit.

Propriety Audit 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 performances and requirements of Government regulations." In propriety audit the emphasis is shifted from documents and vouchers to the substance of the transactions, and their appropriateness on considerations of financial prudence, public interest and wasteful expenditure. It is concerned with the scrutiny of executive action and decisions bearing on the financial performance of the organisation.

The fundamental canons of financial propriety as applicable when dealing with public finance are equally applicable in the case of corporate undertakings also. The principals standards adopted are as follows :

- (a) The expenditure should not be the prima facie more than what is required for the purpose and the person authorising the expenditure should exercise the same degree of vigilance as he would when dealing with his own money.
- (b) No person having the power to authorise expenditure should exercise the power to his own advantage directly or indirectly.
- (c) The funds should not be utilised for the benefit of a particular person or group.
- (d) Apart from the agreed remuneration/computerisation, these should not be left open any other avenue to indirectly benefit the executives or other employees, and allowances should not be allowed to be a source of profit for them.

Cost Audit is in fact in the nature of propriety audit as the above concepts have been built into the structure of the Cost Audit Report. There are specific queries under auditor's observations in the main Cost Audit Report bearing on the above concepts. The Cost Auditor has to give his observations on matters which appear to him to be clearly wrong in principle or apparently unjustifiable.

10.(a) Differences between 'Management Audit' and 'Operational Audit'. (b) Five measures that may be adopted to prevent and control 'Management Frauds'.

(a) Management Audit:

- i. Appraises the efficiency of management at all levels throughout the organisation i.e., top, middle and supervisory levels.
- ii. Management Audit questions the goals and objectives of the management.
- iii. The management Audit is an audit of the management.

Operational Audit:

- i. Operational Audit is review of the performance of only the middle and supervisory levels. Thus the appraisal of top management is beyond the scope of operational audit.
- ii. Operational Audit is considered to be a limited form of Management Audit and is concerned *only* with all the operations of the business.
- iii. Thus operational audit is an audit for the management.

(b) Measures for preventing and controlling Management Fraud: The following are some of the measures for preventing and controlling Management Frauds -

- i. Adequate internal control systems.
- ii. Systems Audit to suggest improvement in systems and procedures.
- iii. Sound personal policies - reviewed and revised, if necessary, periodically.
- iv. Thorough supervision at all levels.
- v. Total transparencies in the office procedures.

11. The requirements to be complied with by a company in respect of corporate governance under the SEBI guidelines, in terms of the listing agreement.

The important requirements of Corporate Governance as per SEBI guidelines:

1. At least 50% of the Board of Directors should be non-executive directors. The proportion of independent directors should be one third, if there is a non-executive Chairman and 50% if there is an executive Chairman.
2. A qualified and independent Audit Committee of the Board should be set up and it should meet at least thrice a year. It should have at least 3 members, all being non-executive.
3. The remuneration of non-executive directors shall be decided by the Board of Directors.
4. The Board meeting shall be held at least four times in a year.
5. A Management Discussion and Analysis Report should form part of the Annual Report to the shareholders.
6. The shareholders must be provided with full details of the person whenever a new director is appointed.
7. There shall be a separate section on Corporate Governance giving details of compliance in the Annual Report.
8. A certificate from the Statutory Auditors regarding compliance with Corporate Governance guidelines should be appended to the Annual Report

12. You are appointed by the Chief Commissioner of Customs to carry out a Special Audit of accounts of a company which manufactures goods in Customs Bonded Warehouse. Detail of the procedures involved and the points to be covered in your report

The procedure for Special Audit of accounts for goods manufactured in Bonded Warehouse has been laid down in the Board Regulations issued in 1966, but the same was considerably simplified in 1998.

- i. The owner should make an application giving full details of the description of the warehouse, process of manufacture, details of imported materials, etc.
- ii. Manufacture or physical removal will not be under the supervision of Customs officers but will be record based. However, the officers have the right to visit the warehouse and control and supervise the process.
- iii. The basic records to be maintained are as follows:
 - Bond register for receipts and issues of materials.
 - Manufacturing Register.
 - Finished Goods Register.
 - Reject/Scrap Register.
 - Export Register.
 - Subcontract Register.
 - Indigenous Goods Register.
 - Sales Register.

The Audit Report should cover the following points :

- i. Details of the manufacturer
- ii. Details of the manufacturing process
- iii. Input-output ratios - norms vis-à-vis actual
- iv. Documents checked
- v. Correlation of Customs documents of Input and Export of Final products with financial accounts
- vi. The details of scrap sales
- vii. Sales in Domestic Tariff Area. (DTA).

The auditor should not make any recommendation on the admissibility of any claim, as it is the domain of the adjudicating authority.

13. (i) Net Worth as per Para 28, (ii) Dumping, (iii) Permanent File, (iv) Audit Committee, (v) Qualified Cost Audit Report.

(i) "Net Worth" as per Para 28 means Share Capital *plus* Reserves and Surplus (excluding revaluation reserves) *less* accumulated losses and intangible assets.

(ii) "Dumping" is the transfer of goods to an alien market, at a price which is less than the marginal cost of its production in the home country. It is an unfair practice and hurts the economy of the dumped country.

(iii) "Permanent File" : The Audit Working Papers are kept in two files "a permanent file" for all the years and "a variable file" for each year of Audit. Copies of "Memorandum of Association", "Articles of Association", "collaboration agreements", Process Flow Chart, "list of cost centres", "manufacturing process", "accounting codes", "accounting codes", "cost manual" etc. may belong to the "Permanent File". Thus permanent file "refers to information which is unlikely to change from year to year.

(iv) Audit Committee: Every Public Company having paid up capital of more than Rs. 5 crores shall constitute a committee of the Board known as "Audit Committee". This committee shall hold discussions; with the auditors periodically regarding internal control systems, observations of Auditors, and shall review half yearly and annual financial statements before submission to the Board to ensure compliance of Internal control systems.

(v) Qualified Cost Audit Report: When Cost Auditor is not satisfied with the data presented to him or if he finds some discrepancy in the data presented to him or if he is not satisfied with any explanations and information given to him, he may qualify his report. In other words, in a "Qualified Cost Audit Report", the Cost Auditor gives his opinion, subject to certain reservations.

14. "Cost Audit" is "Efficiency Audit".

"Efficiency Audit" consists of the appraisal of performance to determine whether or not the plan has been executed efficiently.

The main purpose of Efficiency Audit is to ensure -

- 1) that every rupee invested in capital or in other fields gives optimum returns, and
- 2) the balancing investment between different functions and aspects is designed to give optimum results.

"Cost Audit" may be appropriately called "Efficiency Audit" as outlined above. The following arguments will establish that cost audit is basically efficiency audit:

(i) Cost Audit Report Rule, 4 deals with licensed capacity, installed capacity, actual production, etc., to counter the problem of underutilization of capacity. Thus cost audit can help for improving efficiency by reducing the idle capacity.

(ii) A careful study of information under Para 10 shall bring to focus the areas where wastage of raw materials occur.

(iii) Information revealed by the Cost Audit Report under Para 7 can be of great use for energy conservation and help the firms to improve their efficiency in the utilization of energy resources.

(iv) Para 9 of the Cost Audit Report reveals information for setting up a sound inventory management by revealing useful information re: slow and non-moving inventory and shall help the firm to improve inventory turnover ratio.

(v) Efficiency of industrial units is affected by abnormal costs. An analytical study of information under Para 13 can provide useful information to the firm to improve its working.

(vi) Para 14 discloses information if the funds of the company have been used in a negligent/ insufficient manner.

(vii) Information under Para 12 can help Government to boost its export potentialities. Similarly information under other Paras like Para on financial position of the firm, Inter-firm comparison, and Cost Auditor's observations - all will go a long way for cost reduction, increasing productivity, efficiency of the firm, etc.

(viii) On the basis of the above points, it can be easily established that cost audit is well designed to bring to light the efficiency aspect of performance of a company and is thus appropriately called "Efficiency Audit".

15. The management of a very big Public Sector Company suspects on the existence of "ghost workers". You, as an internal Auditor of the company are required to formulate a system of Internal Control for payment of wages and salaries.

Answer

The following system of Internal Control is suggested, to prevent frauds and payment made to "Ghost Workers", if any:

- i. Every employee should be issued an identity card containing such particulars as Name, Employee No., Department with Photo affixed.
Every employee should be told to have their identity card always with them and they should be able to show that on demand at any time for verification/ checking. One employee particulars register must be maintained by the Personnel Department with signature of the Departmental Head and Head of the institution. At the time of marking attendance and at the time of wage payment, he should show this card.
- ii. The attendance of employees should be recorded by Time clerks/by dropping tokens, after checking in by the Security/Time clerks at the entrance.
- iii. A comparison should be made between the attendance time and time booked to the jobs and this will reveal detection of a dummy worker easily, since there would be no booking in the job card for the dummy worker.
- iv. The system of internal checks should exist for preparation of wages sheets, such that work of each person is checked by another person. All the calculations and entries should then be checked by a responsible person.
- v. Payment of wages should be made in presence of some responsible officers. Shop-floor Foreman should also be present for identification of workmen. In cases, where possible, payment should be directly credited to the bank accounts of the employee concerned.

16. The role of the Audit Committee as per SEBI guidelines and as stipulated in Section 292A of the Companies Act.

Role of the Audit Committee:

A. As per SEBI Guidelines:

- i. Oversight of the Company's Financial reporting process and disclosure of correct financial information.
- ii. Recommending the appointment, removal and fixation of remuneration of the external auditor.
- iii. Review of annual financial statements before submission to the Board, with particular reference to statutory compliances, related party transactions, major accounting entries which have impact on company's profitability and financial strength etc.
- iv. Review of internal control system.
- v. Review of adequacy of internal audit systems, the internal audit reports, corrective actions taken on the audit points etc., including frauds, malpractices.
- vi. To look into the reasons for substantial defaults in payments to the lenders and creditors.

B. As per Sec. 292A of the Companies Act, 1956 :

- i. To have discussions with statutory auditors periodically about internal control systems, the scope of audit, observations of auditors and review annual and half yearly financial statements before submission to the Board.
- ii. To investigate any matter in relation to any of the above matters or referred to it by the Board.

17. A list of precautions and safeguards a Cost Accountant should take before issuing a certificate to a client.

A cost accountant has to be very careful in his certification by taking adequate precaution on the information certified particularly when they are in the nature of projections for the future. In the case of facts and past information, he has to certify with reference to proper evidences and records, whereas in the case of projected information, he is required to look into the reasonableness of simulated information and apply his fair judgment. He should take adequate care of his professional ethics and code of conduct as prescribed for the profession in all its aspects. In cases where alternative methods are available for compiling certain data, the certification shall cover clearly the method followed by the cost accountant, justifying the reasons for the method selected by him. If certain matters are excluded from the purview of certification, such exclusion shall be specifically stated. A cost accountant should take adequate care of consistence in the methods followed without which the information may get distorted.

18. Checklist for carrying out an audit of the Cost-effectiveness of the selling and distribution function in a company which markets cosmetics and toiletries through a network of regional offices, agents and travelling representatives.

Checklist for an audit of selling and distribution function:

- i. Is the sales department adequately staffed or overstaffed. Is the staff distributed based on geographical location or targeted market penetration. Is there flexibility in staff movement based on changes in sales pattern
- ii. Frequency of sales forecasts and their review and revision

- iii. How effective is the system of marketing performance appraisal. Is it based on sales invoiced in absolute rupee terms or other criteria. What are the other parameters used in measuring the performance of individual salesman, such as feedback on customer reaction, competitors' activities, etc..
- iv. Does the system motivate the salesman to give their best performance.
- v. Are the sales budgets realistic. Are they fixed in quantitative terms and/or productwise. Is it linked to production budget, and if so, is there flexibility for changes in product mix requirements by the market.
- vi. What are the procedures established for controlling the expenses of salesmen towards travelling, telephones and other out of pocket expenses.
- vii. Are the travelling sales representatives given extra budget for entertainment of customers (bulk consumers/wholesalers). Is it discretionary.
- viii. Is there any tendency to show higher sales at the end of the appraisal period. Is it correlated with the sales returns of the subsequent period.
- ix. Is there any check on the effectiveness of advertisement in various media.
- x. Is the sales department associated in formulating the credit policy.
- xi. What is the frequency of review of customers' outstanding. Is the review confined to the average outstanding or a detailed customer wise analysis is done. If so, at what level-GM, Marketing Manager, Sales Supervisor, etc.
- xii. What is the procedure for write-off of bad debts or issue of credit notes to customers. Who is competent to authorize such transactions.

19. The risks covered by general insurance in respect of which a Cost Accountant can effectively use Costing methods and techniques in assessing losses.

All risks covered by general insurance can be quantified in one way or the other, and there are clear sales for computation of the loss suffered by the insured. However, the following areas in particular give maximum scope for a cost accountant to use his skills in evaluating the loss:

- a. Fire - in correctly working out the value of goods- lost (raw materials, work-in-progress or finished goods - especially in the two latter cases)
- b. Transit damages or losses - in estimating the cost of repair or the value of goods lost
- c. Loss of profit - in identifying the period costs and the product costs.

Risks such as SRCC or malicious damage involve more legal issues than pure accounting statements.

20. "Energy Audit— its objectives and methodology.

Energy Audit means monitoring the energy efficiency of different operations and processes in a plant and looking into ways and means by which the total sum of energy consumed can be cut down without affecting production. It serves to identify all forms of energy consumed by a facility and to quantify every form of energy used in relation to discrete functions.

The methodology employed to carry out an energy audit is -

- i. Forming a multi-disciplinary team
- ii. Conducting a survey of use of every kind of energy such as coal, oil, steam, electrical units, chilling, refrigeration etc.
- iii. Department wise energy consumption computation
- iv. Study of energy generation
- v. Study of distribution of energy
- vi. Conducting technical studies of energy uses
- vii. Identifying opportunities for conserving energy in each department/operation.
- viii. Heat recycling
- ix. Identifying alternative sources of energy
- x. Studying Heat balance
- xi. Examining the use of better variable driers, etc.
- xii. Improving power factor.

21. The requirements of Cost Audit Report Rules in regard to installed capacity and production.

Para 4 of the Annexure to the Cost Audit Report calls for information in regard to production under the following among other heads :

- i. Installed capacity
- ii. Capacity enhanced during the year
- iii. Total available capacity
- iv. Production during the year
- v. Capacity utilization percentage.

The capacity should be expressed wherever necessary in standard measurable terms.

The percentage of actual production to installed capacity has a direct bearing on the unit cost of production. If there is imbalance in production capacity between different departments, there will be idle capacity in some departments and the depreciation and other fixed overheads of those departments will be unnecessarily loaded to the cost of production. In computing the unit cost of production, the fixed expenses attributable to idle capacity should be excluded, to ensure that the cost is at normal value.

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

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 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(l)(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.

23. The relevance of Cost Audit in India

Liberalization and Globalization: The liberalization of the economy has increased the relevance of Cost Audit in India more than ever before. In the present competitive scenario of globalization; the Cost Audit Reports have assumed greater importance and significance as the only source of reliable and authentic feedback to the government and its various departments and agencies. It has become very important that the product and services are made more competitive by constantly improving efficiency by reducing vital input costs and reduction of wastage. This constant exercise has to be monitored by Cost Audit only.

For toning up efficiency and productivity: Cost Audit is a powerful tool to highlight areas of inefficiency and improving performance. As such the need for Cost Audit is more in the present scenario than before.

Antidumping: The Cost Record and Cost Audit Report will play a good source document for the Indian exporters to substantiate their fair approach against any allegation of dumping. Further, for imposing Anti-dumping duties on the import into India, the expertise of Cost Auditors and certification by them will be useful.

Transfer pricing issue: Cost Audit Report rules, 2001 have been amended to take care of the issue of 'Transfer Pricing' in right perspective in judging its impact on business activities.

Audit Committee: The formation of Audit Committee is a big leap in ensuring good corporate governance. Cost Auditor plays a key role in the Audit Committee meetings.

Major source of information for Direct & Indirect Tax authorities: An independently verified audited Cost Records and the resultant Cost Audit Report become a major source of information, which can be effectively used by both the Direct & the Indirect Tax authorities.

Serves Central Excise authorities: The Cost Audit Report is used by Central Excise Authorities for verifying the claim of the companies relating to ex-factory prices of the excisable goods, especially in the case of Inter-unit transfer.

Fixation of Tariff by the Tariff commission: The Tariff Commission relies on the authenticity of the Cost Audit Reports for fixing the tariff of the products, covered under Cost Accounting Records Rules.

Other relevant roles: Cost Audit serves the interests of shareholders. It is also made use of by income Tax Authorities. Further, the Banks and Financial Institution also find the report as useful. The Cost Audit Report is used as evidence by DGIR (Directorate General of Investigation and Registration) in pursuit of cases with the MRTTP Commission.

24. Your company has received an order from the Government of India directing your company to have the Cost Accounting Records audited. 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.

- 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 no 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.

25. (a) The circumstances which have brought about the development of "Management Audit". (b) The statutory and specific field of audit, verification and certification open to 'Cost Accountants in Practice' other than the Cost Audit.

(a) Uses of Management Audit:

- i. Management audit is useful in synthesizing, accounting, economic and other data required by management in constructing basic policy framework.
- ii. Management audit assist in establishing, reviewing and improving the planning system.
- iii. Management audit makes substantial contribution to system of goal setting in the organization.
- iv. Management audit ensures that the management is getting the adequate information for correct decisions.
- v. Management audit ensures that the management properly uses the information that it is getting.
- vi. Management audit aids in the design and maintenance of adequate authority structure.
- vii. It helps in the improvement information system to expedite flow of information among responsibility centers.
- viii. It substantially contributes for improvement of entire communication system.
- ix. It helps management in pinpointing key functions or operations in the profit making process.
- x. It helps management in establishing better criterion for measuring results.
- xi. It helps management to avoid wasteful, unnecessary and extravagant use of resources.

The following factors have led to the development of 'Management Audit': -

Size, scale & complexity of business Operations: The very size & scale of business operations have lent complexity to the affairs of the organizations. Eventually a stage comes when further development / expansion is either uneconomic or unmanageable. In order to deal with the problems of complexity, a number of techniques and tools have been developed - out of which Management Audit is one such technique - basically meant to overcome the human limitations of top management.

Need to improve productivity: The industrial development to-day is characterized by a continuous search for improvement of productivity-cum-efficiency through economic utilization of resources-national, physical, human and capital-because of their constraints and limitations. This has called in for Management Audit to cope up in a world of diminishing resources.

Granting financial subsidy by the Govt. / Financial Institutions to sick enterprise is preceded by identification of problems, as faced by the company. This calls for the necessity of Management Audit.

Take over Bid's: When a business firm plans to acquire another business enterprise/the Govt. desires to take over any enterprise, the acquiring organization needs to study and evaluate fundamentally (the other firm's financial, technical and managerial aspects - which call for a Management Auditor's study.

Societal Need: A business unit to-day has to meet the needs of the society in order to survive. Management Audit will be able to guide the company for industrial management of social-well-being.

Equity participation: LIC, IFC, UTI and different financial Institutions may like to conduct Management Audit of the company before deciding for Equity participation.

Foreign Collaboration: The foreign collaborators, while investing funds in the associated companies, may feel the necessity of conducting Management Audit of those units for which collaboration agreement is likely to be finalized. This will ensure that the funds are invested for growth and expansion.

(b) The following are some of the statutory and specific field of Audit open to the Cost Accountants in practice:

- i. Internal Audit: in industrial and commercial enterprises run by some of the State Govt. / Central Govt. Undertakings.
- ii. Central Excise: Certification of cost of production, for goods used for captive consumption, under Central Excise Rules.
- iii. Income tax: U/S 288(2) of I.T. Act & I.T. Rules, Cost Accountants are entitled to appear as Authorized representatives before I.T. Authorities.
- iv. Excise Audit: Practicing Cost Accountants alone are authorized for Excise Audit U/S 14A and 14AA of Central Excise Act.
- v. Companies Act: Under Rule 28, practicing Cost Accountant can appear before the Company Law Board Benches as authorized representatives.
- vi. B.I.F.R: Practicing Cost Accountant can be appointed to assist B.I.F.R.
- vii. Drugs (Price Control) Order, 1987: Practicing Cost Accountant is authorized to certify various forms specified in the fourth Schedule under D.P.C., 87.

- viii. Import/Export: A Cost Accountant in practice is authorized to certify documents under Import/ Export policy & procedure as per notification 326/PN/92-97 of 10 Nov., 1995.
- ix. As Concurrent Auditor: P.C.A. can be appointed as Concurrent Auditor by the various All India financial institutions.
- x. Inventory Audit: P.C.A. can accept assignments for the inventory audit in Banks/financial institutions.

26. The scope of work for Cost Accountant in practice as a loss assessor. The types of claims and the role of the Cost Accountant in assessing the quantum of loss.

Scope of work as a Loss Assessor.

The Controller of Insurance, Government of India, has recognized the Cost Accounting qualification as equivalent additional technical qualification for granting of license u/s 64 UM of the Insurance Act for appointment as a Surveyor or Loss Assessor. There are various types of general insurance policies such as: Fire, Marine, Accident, loss of profit, fidelity guarantee, malicious damage, natural calamities, etc. The term "marine" also includes inland transit by road or rail.

The Surveyor should thoroughly study the terms and conditions of the policy and understand the types of risks covered, restrictions on the claims, conditions to be fulfilled by the policyholder etc.

Loss generally arise due to one of the following reasons:-

- i. Marine- Loss in transit due to leak, pilferage etc.
- ii. Damage in transit due to accident or improper packing.
- iii. Strikes, Riots of Civil commotion.
- iv. Fire- Loss of stock or plant and Machineries.
- v. Accident- Road accident involving vehicles accident within the factory e.g., explosion in a chemical plant.
- vi. Malicious damage- willful damage of equipment by militant trade unions or political parties.
- vii. Fidelity guarantee- Misappropriation of cash by cashier.
- viii. Cash-in-transit, cash-in-safe etc. etc.

In all the above cases, the surveyor should assess the quantum of loss strictly as per conditions laid down in the policy. The Insurance Surveyors measures/ assess and report on the insured's financial loss. Their report is the basis in which the insurance companies compensate the insured. The ethics of the insurance surveyors' profession are broadly laid down in subsection 7 of section 64 UM of the Insurance Act. The surveyor shall not suppress any material fact having a bearing on the claim. In all the above spheres, the Cost Accountant can play an effective, role in assessing the actual quantum of loss and assist in the settlement of claim.

- 27 (a) A factual report is given to a newly appointed Chief Executive of a company (after a month of assuming the charge) regarding his staffs are by and large demoralized.
- (b) The review of 'Marketing Policies'- as a part of corporate development by a Management Auditor of a large organization.

(a) A report on demoralization of employees.

The investigation reveals that by and large the employees of the firm are demoralized and dispirited. There is a total absence of commitment and initiative on their part. There is a growing discontentment among the employees. The following are the specific factors for the grave demoralization amongst the employees :-
Insufficient promotion opportunities. There is no system of 'Individual career growth plan'. Some employees are stagnant and are not getting promotion for long years. Such employees are totally frustrated and demoralized. A statement showing the details of persons stagnating for over 6 years' in the same post (discipline-wise) is put up vide Exhibit No. 1 attached. Preference is given to Direct Recruitment over internal promotions. There is no 'Management Succession System' and there is no system of 'Potential Spotting' amongst the employees. Neither the company is serious about training its Human Resources in their functional areas. Direct recruitment in Management and senior staff position is being resented to by the Management. There is considerable imbalance in workload and in overtime opportunities. There is a system of assignment of personnel to tasks that do not interest/encourage them. There is no "Employee Participation" in Management. The application of modern concepts like 'Job Enrichment', 'Job Rotation', 'Job Evaluation', 'Merit Rating' etc. are totally absent in organization. There is no scientific performance Appraisal system. Apart from the above, the human aspects of personnel development viz. the program of informal education, recreation & culture, community development etc. to enhance the quality of work-life are totally being neglected. The company has been pursuing with wrong personnel policies and procedures. There is favoritism and nepotism by the management. There is no transfer policy and employees are transferred at the whims and fancies of the management.

(b) A questionnaire for review of 'Marketing Policies' of the company.

(i) Consumer needs assessment:

Is the policy rationale in terms of marching customers' needs with the firm's offerings and capabilities.

What is the likely consumer reaction.

What were the evaluations studies undertaken to assess consumer reaction, particularly, in respect of-product features, price, distribution outlets, new product concept, and new product introduction.

(ii) Market segmentation:

What is the target market conceived.

Is the market segmentation based on empirical data, such as - usage, demographics, benefits sought, consumer characteristics etc.

(iii) Competition and product position.

How many are competitive producers.

What is company's share in the total market.

How many competitions have left the market over the last few years.

What is the general competitive environment.

What particular product characteristics does the firm possess that contribute to the market place.

What is the relative market position of the products at different stages of their 'life cycle'.

(iv) Marketing Mix:

How is the optimum mix of pricing, distribution and promotional policy for each of the products of the firm determined.

What are the company's approaches to issue like Product Design, Product Positioning, Price-range, advertising and promotion media etc. etc..

(v) Marketing Program:

Is the marketing program of the company designed to emphasize lower price, mass distribution channels and mass advertising to reach numerous market segments.

(vi) Resource Allocation.

Does the marketing program take into account the inter-dependencies among the various options and a Resource Allocation Procedure to direct the company's commitment of resources among products, market segments and the related marketing strategies to accomplish the objectives.

If so, how is the resource allocation procedure has been established for different marketing decisions.

28.(a) As a cost auditor, you will deal with the following.

- i. A company has produced all accounting records within the stipulated time for your audit. It however is unable to produce audited financial accounts, as financial audit is not yet complete.
- ii. A company has not maintained cost accounting records though having the obligation under section 209(1)(d) of the Companies Act, 1956. The management is of the opinion that necessary steps could be taken after the cost audit order is received from the Government. Are the directors of the company absolved of the obligation to maintain cost accounting records.
- iii. A company, which manufactures cables and conductors, has charged only a portion of the administrative overheads to cost of production and the balance to the cost of sales of its products.
- iv. A sugar mill, which produces sugar from sugarcane, uses bagasse as fuel to produce steam. In its cost statement, such input of bagasse is valued at nil value, as according to the company, it has incurred no cost in acquiring bagasse, which is only a waste product.
- v. During plant stoppages, the operational labour is being utilized by the company for cleaning, oiling and such other routine jobs of the same plant. Their wages for that period also are treated as direct wages in cost of production.

(b) An Unbalanced Plant' and the different options as a Cost and Management Auditor, would like to offer as 'rectification techniques' to remove 'imbalances' for ensuring better economic utilization of such a plant.

(a)

- i. In case where the Cost Audit Report is finalized with provisional figures a forwarding letter should be attached by the Cost Auditor to the aforesaid report stating clearly that the company has been unable to produce audited financial accounts since the financial audit is not yet complete. As such the report submitted is based on unaudited/provisional figures only as has been given to him by the company. Subsequently a supplementary report should be submitted by the Cost Auditor to the Government as soon as the audited financial accounts are made available.
- ii. The obligation to maintain cost accounting records as per the rules provided u/s 209(1)(d) is a continuing one, independent of whether cost audit is ordered or not. Further the manual auditor also has an obligation to certify under CARO that such cost records have been made and maintained. As such the directors of the company will not be absolved of the obligation under sec.209(1)(d).
- iii. In case administrative overheads are not analyzed separately, these may be apportioned to the cost of production and the cost of sales on some appropriate basis. In the instant case, the company is correctly treating the administrative overheads. However, the Cost Auditor should check the following in this connection:
 - Apportionment of administrative overheads to the cost of production and the cost of sales is on an appropriate basis; and
 - This practice is consistently followed from year to year.
- iv. Bagasse is a by-product in sugar industry, which has a realizable value. As the company is using bagasse as a fuel to produce steam, the bagasse should be valued at its realizable value. Thus taking bagasse at 'nil value' is not correct.
- v. Where operating workers are required to perform certain type of work which otherwise falls in the category of indirect labour, like oiling, cleaning, maintenance etc., their wages should be treated as indirect wages and accordingly included in the overhead.

(b)

An Unbalanced Plant: is a plant in which some of the machines or work centers are overworked relative to their capacities while other work centers are underutilized. Such a plant is characterized by:

- Bottlenecks due to overworked machinery/equipment
- Under-utilization of some machinery
- Inefficiency and high unit cost.

An unbalanced plant is a drag on the efficiency and profitability of the enterprise. Therefore, it is necessary to rectify an unbalanced plant so as to maintain proper balance, minimized costs and maximize profits.

Rectification Techniques: The following measures may be adopted for better economic utilization of an un-balanced plant:

- i. Some extra machines may be hired on rental or lease basis to ease overload on certain machines,
- ii. In case overload is a regular feature, orders may be placed for new machines, which may be fully utilized in the long run.
- iii. Multiple shifts may be introduced to stretch the capacity of overworked machines,
- iv. Overtime may be allowed to workers on bottleneck machines,
- v. Increase the speed of bottleneck machines to the maximum possible extent
- vi. Under-utilized machines may be sold out
- vii. Improvise under-utilized machines to adapt to other types of work
- viii. More orders may be procured to keep under utilized machines busy.

29. The preliminary information to a Cost Auditor how he will collect it from the company which is subject to cost audit for the first time.

The following information from the company is generally required by a cost auditor relating to cost audit:

- i. A brief history of the company and its business activities.
- ii. Memorandum of Association and Articles of Association.
- iii. Annual reports and accounts for the last three to five years.
- iv. A list including addresses of all factories, branch offices and depots with the names of managers-in-charge.
- v. Organization chart with details of key personnel.
- vi. Collaboration agreements, if any, including agreements for payment of royalty.
- vii. Details of manufacturing capacity - installed, licenses and utilization of installed capacity for the last three years.
- viii. A detailed note indicating the system and procedure followed in:
 - Cost department
 - Financial accounting department
 - Purchase, raw materials/ packing materials stores etc.
 - Time office
 - Production department
 - Sales department
 - Management Information System
 - Internal audit department
- ix. Copies of budget manual
- x. Flow charts and description of manufacturing process
- xi. Major raw materials with quantitative details for each; unit of finished output
- xii. Labour incentive schemes, if any
- xiii. Details of budgetary control and standard costing procedures with treatment for variances.
- xiv. Copies of industrial licenses, if any, issued from time to time
- xv. Periodical reports submitted to Excise and other Government authorities.

30.(a) The Managing Director of a company wants advise from a management auditor on the points to be considered for take over of a manufacturing company. (b) Today's customer is the more demanding than the customer of yesterday. In view of this, the evaluation of a Management Auditor of, Customer Services Department".

(a) Take over of a business of a company by another company or the merger of two business units has become quite common these days in India. It may be a case of a sick business unit being taken over by a healthy unit or taking over may be the purpose of expansion, diversification, vertical integration, etc. The Management Auditor will have to evaluate and advice on taking over or merger proposals and the terms thereof. The following points should be kept in mind by the management Auditor while advising on the takeover of a manufacturing company:

- Legal restrictions if any under different laws like MRTP Act, FEMA, Company's law, IT Act etc
- Reasons for the company being offered for sale. If it is a sick unit, reason for its sickness.
- The activities of the manufacturing company- Is it compatible with the company taking over or is it a diversification plan.
- Production capacity.
- Profit performance for previous 3 years.
- Projected profit performance for next 3 years.
- Order booking position,
- Competitors' profiles.
- Pattern of share holding.
- Details of financial and technical collaboration, terms and conditions regarding termination, continuation etc.
- Technological advantages, if any.
- Long term contracts entered into by the company.
- Insurance cover of its assets.
- List of major plants and equipments etc.
- Past financial records of the company, accounting system etc
- Pending court cases, if any.
- Income tax, sales tax/VAT issues.

- Details of contingent and other liabilities not provided for.
- Raw materials and other inputs.
- Labour relations and wage rates.

(b) A customer is the most important person for a business because it is he who provides the profit. Therefore, the starting point in any marketing strategy is identifying the customers, their needs and organizing the efforts of the company towards satisfying such needs.

In order to create and retains customers, certain services are to be provided by properly attending to their needs and supplying right quality goods at the right price. Such services would not only stimulate the demand for the products of the company but also will help to establish product acceptability and widen the scope of potential customers. Customer services may be evaluated on the following lines:

- Do the products manufactured by the company meet the needs of the customers of different purchasing power and different tastes.
- Are the prices of the products reasonable, considering the product quality.
- Are the prices competitive to similar other products available in the market.
- Are the customers given prompt and personal attention.
- Does the company guarantee the quality of its products.
- Does the company provide after-sales services.
- Are the customer complaints carefully and promptly attended to.
- Are spare parts of the products easily available in the company offices and in the open market.
- Are the products properly packed to avoid any damage to its products.
- Is there any provision for home-delivery services.
- Does the company undertake marketing research in regard to customer behavior and customer services.
- Does the company make use of marketing research data to improve customer services.
- Does the company's products bear ISI Mark/AGMARK.
- Are the company's products easily available at various retail outlets.
- How effective are the various channels of distribution used by the company.
- Does the company educate the customers about the use of the products through printed material and other means.
- Are the sales man retailers continuously motivated to provide the best attention and services while selling company's products.

31 (a) Management frauds; and with the system a management auditor will prevent and control these frauds.

(b) As a management auditor of an engineering company, you are requested to submit a report to the management suggesting suitable control procedures for wastage, scrap, spoilage and obsolescence of materials. Draft a report explaining the areas, which you would like to highlight.

(a)

Fraud is an intentional misrepresentation of facts. In general it is seen that top executives like Managing Directors, General Managers and other such executives, occupying top 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 managers for their personal benefits may commit such frauds in kind or in cash. On account of their fiduciary position and having easy access to the assets and greater power to control accounting and financial statement preparation, the managers have better opportunities to defraud the company and others. Such frauds may take the form of misappropriation of assets and manipulation of records.

Control and prevention of Management Frauds: Control and prevention of Management Frauds is the responsibility of the management. But when the top management itself is perpetuating frauds, it becomes very difficult for the auditors or for that matter anyone else to detect it.

The following measures may be adopted for the control and prevention of management frauds:

- Adequate internal control system may be introduced.
- System audit should be conducted to suggest improvement in systems and procedures.
- Organization structure of the company should be reviewed and reconstituted, if necessary.
- Personnel policies of the company should be reviewed and revised, if necessary.
- Supervision at all levels should be tightened.
- Information revealed by inter-firm comparison of performance should be thoroughly analyzed.
- Proper office procedures should be introduced.
- All significant variations from the Budgets or Standards should be checked in detail. The top management should be basically interested to control and prevent occurrence of management frauds.

(b)

The Managing Director,
M/s XYZ Co,
Respected Sir,

Dated.....

Sub: Control procedures for Wastage, Scrap, Spoilage and Obsolescence

With reference to your letter dated.....requesting us to examine and report on the system of control and accounting of scrap, wastage, spoilages etc., in your company we would like to suggest the introduction of the following procedures/controls, with a view to ensure proper control:

Procedures/controls, with a view to ensure proper control:

- For identification of waste, scrap, spoilage and obsolete materials, standards based on their values and utility will have to be fixed.

- Output should be measured at the time of production and means to determine whether the quantity of scrap generated is normal or excessive should be established.
- Basis for reconditioning or reusing, the scrap materials should be fixed.
- The scrap generated should be properly accounted for, to avoid misappropriation. Proper arrangement should be introduced for their storage.
- The scrap should be properly graded, taking into account their utility and realizable value.
- Responsibility for sale of scrap should be fixed and scrap should be sold out at periodical intervals.
- Standard ratios should be developed to control the occurrence of spoilage depending on the conditions either normal or abnormal. Proper recording and reporting of spoilages should be done. Control over the storage and handling of spoilages should be introduced.
- Proper basis should be introduced for reprocessing or for disposal of spoilages.
- Spoilages should be accounted for at the point of their production.
- Method of utilization of spoilages should be standardized.
- On regular basis, reports re: slow moving and nonmoving materials should be obtained and action taken to prevent unnecessary purchasing.
- System should be developed for keeping track of obsolescence items.

We would request you to kindly initiate steps for implementation of the above suggestions Please feel free to ask for clarifications, if any.

Always we remain at your service.

Yours faithfully,

XXXX

(Management Auditor)

32. Evaluation of the personnel function of an organization by the management auditor is by no means an easy task – the areas to be covered while assessing the personnel function of an organization:

It is very true that evaluation of the personnel function of an organization by the management auditor is by no means an easy task. The Management Auditor needs to cover a large number of areas during his task of assessing the personnel function of an organization.

Important Areas that are to be covered: In our view the following are some of the important areas that are to be covered while assessing the personnel function of an organization:

- Procedure for recruitment, promotion, transfers and training
- Action plan for reducing absenteeism.
- Method for wage payment and incentives.
- Methods developed to analyze labour turnover and steps taken for their reduction.
- Steps taken for reducing accidents and preventive measures for safety.
- Welfare measures.
- Labour productivity improvements.
- Discipline and toning up employee morale.

Points to be kept in mind while assessing the personnel function of an organization

The following are some of the important point that is to be kept in mind while assessing the personnel function of an organization:

- It is rather difficult to exactly quantify the influence or effects of the human factors and its contribution to the success or failure of the organization.
- It is also difficult to develop a yardstick for the measurement of the performance of a large group of workers in a big organization.
- The fellow workers and the industrial environment influence the workers.
- Dealing with human being is always a difficult task. It is necessary for the organization to motivate workers in a proper way and bring them together towards a common goal.
- The management auditor should assess whether the supervisors and the managers possess leadership qualities and dynamic ideas to motivate their personnel.
- The personnel function is very important function because in the absence of a well-organized personnel function, the company will not be able to utilize other resources in an optimum manner. In fact human resource is the most important asset in any organization.

33. The steps to be taken by a company from the time the Cost Audit is ordered for its product and the Report is submitted by the Cost Auditor to the Government, specifying the time schedules and penalties for non-compliance.

The following are the steps to be taken by a company brought under the Cost Audit for the first time:

- i. Shortlist a panel of Cost Accountants in practice and place it before the Board of Directors for selection of a Cost Auditor
- ii. Board will pass a resolution proposing the name of Cost Auditor and fix his remuneration. Prior to this, the company should obtain a certificate from the Cost Auditor under Section 224(I-B) that he does not suffer from any disqualification and that the audit will be within the ceiling of number of audits prescribed.
- iii. Make an application in form 23 C to the Central Government seeking approval for appointment of the Cost Auditor, with the prescribed fee.
- iv. Approval of the Central Government will be communicated to the company, with a copy to the Cost Auditor.

- v. The company shall periodically make available to the Cost Auditor the Cost Accounting Records prescribed under section 209(1)(d), of the Companies Act, 1956.
- vi. Within 135 days from the close of the accounting year, the company shall prepare the Annexure to the Cost Audit Report under the Cost Audit Report Rules, 2001 and submit to the Cost Auditor for his audit.
- vii. Within 180 days the company shall place before the Board of Directors Annexure to the Cost Audit Report and Product Cost Sheets for their approval. Subsequently they should be signed by the secretary of the company and one Director/by the two Directors and forwarded to the Cost Auditor for his signature and submission to the Central Government (Cost Audit Branch)
- viii. The Cost Auditor shall within 180 days from the close of the accounting year, audit the Cost Accounting Records under section 209(1)(d) and the Annexure to the Cost Audit Report and submit his Report to the Central Government with a copy to the Company.

Penalties for non-compliance: If the company contravenes the provision of the Companies Act or Cost Audit Report Rules, the Company and every officer thereof in default shall be punishable with fine, which may extend to Rs.5000/- and where the contravention is a continuing one, with a further fine which may extend to Rs.500/- for every day during which such contravention continues. If default is made by the Cost Auditor in complying with the provisions, he shall be punishable with fine, which may extend to Rs.5000/-

34. The requirements of the Cost Audit Report Rules 2001, in regard to inventory. The relevance of the information called for in different paragraphs of the Annexure to the Cost Audit Report to the product cost. The following paragraphs are the Annexure to the Cost Audit Report prescribed under the Cost Audit Report Rules relate to inventory.

Non-Moving Stock (At the End of the Year)

Particulars	Current Year	1 st Previous Year	2 nd Previous Year
a1. Total direct material consumption			
a2. Closing stock of direct material			
a3. Value of non-moving stock			
a4. Percentage of a3 to a2			
b1. Total indirect material consumption			
b2. Closing stock of indirect material			
b3. Value of non-moving stock			
b4. Percentage of b3 to b2			
c1. Work-in-progress			
c2. Closing stock			
c3. Value of non-moving stock			
c4. Percentage of c3 to c2			
d1. Finished Goods			
d2. Closing stock			
d3. Value of non-moving stock			
d4. Percentage of d3 to d2			
e1. Total:			
e2. Closing stock			
e3. Value of non-moving stock			
e4. Percentage of e3 to e2			

Written Off Stock (During The Year):

Particulars	Current Year	1 st Previous Year	2 nd Previous Year
1. Direct Material (Raw Material & Components etc)			
2. Indirect Materials			
3. WIP			
4. Finished Goods			
5. Total			

Inventory Valuation (At the End of the Year):

Particulars	Basis of Valuation	Current Year			Previous Year		
		Qty. (unit)	Rate (Rs.)	Amt. (Rs.)	Qty. (unit)	Rate (Rs.)	Amt. (Rs.)
1. Input materials:							
(i) Purchased							
- Indigenous							
- Imported							
(ii) Self manufactured							
2. Chemicals, additives and consumables							
3. Stores and spares							
4. Packing materials							
5. Tools and implements							

and figs, Dies and Fixtures.									
6. Work-in-progress:									
(i) material cost									
(ii) conversion cost									
(details to be given)									
7. Finished goods:									
(i) unpacked									
(ii) packed									
8. Scrap/wastage									
9. Others, if any									
10. Total value of inventory as per cost accounts									
11. Total value as per financial accounts									
12. Reasons for major differences, if any									

Physical Verification of Inventory:

Particulars	Periodicity of verification	Storage value (Rs.)	Excess value (Rs.)	Net (Rs.)
1. Raw material				
2. Chemicals, additives, consumables etc.				
3. Stores & Spares				
4. Packing Materials				
5. Tools and Implements				
6. WIP				
7. Finished Goods				
8. Scrap, Wastage				
9. Total				

In all the above cases, the values are to be given separately for raw materials, chemicals, additives and consumables, stores and spares, packing materials, tools and implements, work-in-progress, finished good and scrap/waste.

Besides, the basis of valuation, periodicity of verification, etc. are also to be given:

- Raw Material Stock in term of number of months of consumption.
- Stores and Spares Stock in term of number of months of consumption.
- Work-in-progress Stock in term of number of months of cost of production.
- Finished Goods Stock in term of number of months of cost of sales.
- Scrap/Waste Stock in term of number of months of cost of Scrap/Waste.

A close analysis of the above data will help the auditor to assess the efficiency of inventory management, turnover of working capital, imbalance in the product mix and idle capital employed in the form of non-moving stock. All these factors have direct relationship to the cost of sales of product, as the funds blocked in idle stock will increase the interest burden.

35. "Anti-dumping duty"—the provisions in the Cost Accounting Records Rules and Cost Audit Report Rules, 2001 covering this aspect.

Anti-dumping duty: 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 an additional import duty which is called 'Anti-dumping Duty'. The W.T.O. under GATT '94 had 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 Records Rules prescribed during the last few years provide for maintenance of proper records-whenver W.T.O. 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 W.T.O. provisions.

So, levy of such Anti-dumping Duty is permissible as per W.T.O. agreement, Anti-dumping action can be taken only when there is an Indian industry producing "like articles".

Dumping duty for W.T.O. Countries: Section 9B provides restrictions on imposing dumping duties in case of imports from W.T.O. countries or countries given "Most Favoured Nation" by an agreement. Dumping duties can be levied on import from such countries, only if Central Government declares that import of such articles in India causes material injury to industry established in India or materially retards establishment of industry in India.

Quantum of Dumping Duty: The anti-dumping duty will be dumping margin or injury margin whichever is lower. Injury margin means difference between fair selling price of domestic industry and landed cost of imported product. Landed cost will include 1% and basic custom duty.

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 constructed 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 W.T.O. regarding antidumping measures under Article VI of GATT'94.

The Cost Audit (Report) Rules, 2001, calls for the Auditors observation/suggestion on steps required to strengthen the company under the competitive environment especially with regard to need for protection from cheaper imports, if any. For this purpose, the company is required to provide data in para 22 of the Annexure to the Cost Audit Report.

36. The purpose of the audit prescribed u/s. 14AA of the Central Excise Act. As a Cost Accountant in practice, Commissioner of Central Excise has appointed you to examine and report for correctness for the credit of duty availed and utilized under the Rules by a manufacturer is within the normal limit. The possible areas for misuse/malpractice.

The special purpose of audit under section 14AA of the Central excise Act is as follows: If the Commissioner of Central Excise has reason to belief that the credit of duty availed of or utilized under the rules by the manufacturer is not within the normal limits, or has been availed of or utilized by reason of fraud, etc. He may have the accounts of the manufacturer audited by a Cost Accountant nominated by him.

The following aspects will cover under this section:

- (a) Type of industry.
- (b) Principal raw materials used and the input output ratio of raw materials.
- (c) Percentage of scrap/waste/loss and its comparison with the standard and actual.
- (d) Value of input for which the CENVAT credit availed and the value of input consumed in the product/manufacture.
- (e) In the case of consumables for which CENVAT has been availed whether expenses charged to revenue are gross or net of CENVAT.
- (f) In the case of capital goods for which CENVAT has been availed whether depreciation has been claimed on the element of CENVAT included in the cost of capital goods.
- (g) Procedure adopted for payment of duty on goods sent to sub-contractors/other factories of the Assessee.

The following are the possible misuse/ malpractice:

- i. Consumption of inputs has shown in higher side than the norms and corresponding higher wastage /scrap/ loss. The result of that paying duty on lower production and availing CENVAT on higher input.
- ii. Claiming CENVAT on inputs used for production of goods exempted from duty.
- iii. Claiming CENVAT on capital goods which are specially excluded.

37.(i) Energy Audit,(ii)Valuation Audit and Cenvat Audit ,(iii) Dumping, (iv) Safeguard Duty, (v) Management Audit, (vi) SWOT Analysis, (vii) Productivity Audit

Answer

(i) 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.

Energy utilization and conservation play an important role in an industry in the present circumstances of rapid diminishing fossil fuels, explosive price rise in the area and a possible switchover to alternative source of energy both for conserving energy costs and attempt alternative source of energy.

(ii) Valuation Audit and CENVAT Audit:

Valuation is one of the most vital and important aspect of assessment of excise duty payable, in order to ensure that duty is being paid on correct "Assessable Value", a provision has been made to order a 'Special Audit' in some specific cases, vide section 14A of CEA. The audit can be ordered with prior approval of Chief Commissioner of Central Excise.

U/S 14AA of CEA, 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 Central Excise has reason to belief 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 miss-statement or suppression of facts. Such audit can be done by practicing Cost Accountant to be appointed by the Commissioner of Central Excise. Remuneration and expenses shall be paid by Central Government (Excise Department).

(iii) Dumping is the transfer of goods to an alien market at a price which is less than the marginal cost of its production in the home country.

(iv) Safeguard duty is a step in providing need based protection to domestic industry for a limited period with the ultimate objective of restoring free and fair competition.

(v) According to CIMA terminology management audit is an objective and independent appraisal of the effectiveness of the managers as well as the corporate structure itself in the achievement of company objectives and policies.

Its aim is to identify existing and potential management weaknesses within an organization and to recommend ways to rectify or remove these weaknesses.

(vi) SWOT Analysis means the analysis of strengths, weaknesses, opportunities and threats of an organization and assist in making the organization stronger. It is a technique adopted in the course of management audit while the first two, (strength and weaknesses) are internal to the organization, the other two (opportunities and threats) pertain to the external environment. The strengths and weaknesses may exist in any of the functional areas, and the opportunities and threats may be due to Government policies, uncertainty in power availability.

threats from competitors, etc.

(vii) Productivity audit is basically the analysis of the productivity of the resources deployed by an organization. The resources would include not only money, but men, materials, machinery and methods. Productivity audit is the process of monitoring and evaluating organizational practices to determine whether functions, programmes and the organization itself are utilizing the resources effectively and efficiently to accomplish corporate objectives. It is measured in terms of the relationship between the output and input of the above resources in physical and/or financial terms.

38. The information has to be provided by a Cost Auditor for "Written off Stock" during the year under Para 18 (B).

Under Para 18(B) the following information has to be provided by the Cost Auditor.

1. Direct Material
2. Indirect Material
3. WIP
4. Finished Goods
5. Total

The information may be further grouped in various categories suitable for analyses. Cost Auditor should review

- a) the cause explained by the company for "written off" of the items.
- b) the action taken by the company for recovery of realizable value/ residual value
- c) the accounting policy of the company for written off of various categories of inventory.

39. Corporate Governance – the key aspects which should be shared by the Board.

Corporate Governance is a system by which companies are directed and controlled by the management in the best interest of the shareholders as well as others with greater transparency and better and timely reporting.

Corporate Governance is key to survival in the competitive business environment and the corporate governance codes all over the world are directed to achieve good Corporate Governance through Non-executive Directors.

The following aspects which should be shared by the Board are as follows:

- i. Annual operating plans and budgets together with updated long term plans.
- ii. Capital Budgets, man-power and overhead budgets.
- iii. Quarterly results for the company as a whole and its operating division for business segments.
- iv. Internal audit reports, including cases of theft and dishonesty of a material nature.
- v. Details of any joint venture or collaboration agreement.
- vi. Transactions that involve substantial payment towards goodwill, brand equity or intellectual property.
- vii. Labour problem and their proposed solutions.
- viii. Fatal or serious accidents, dangerous occurrences and any effluent or pollution problems.
- ix. Default in payment of interest or non-payment of the principal or any secured creditors or financial institutions.
- x. Recruitment and remuneration of Senior Officers just below the Board level, including appointment or renewal of the Chief Financial Officer and the Company Secretary.
- xi. Show Cause, demand and prosecution notices received from the revenue authorities which are considered to be materially important.
- xii. Quarterly details of foreign exchange exposure and the steps taken by management to limit the risk of adverse exchange rate movement.

40. (a) VAT; (b) Service Tax; (c) Desk Review of EA-2000 Audit; (d) Management Audit Programme.

(a) VAT stands for "Value Added Tax". Concept of VAT has been developed to avoid cascading effect of taxes.

VAT has been found to be a very good and transparent tax collection system which reduces tax evasion, ensures better tax compliance and increases tax revenue.

Generally, any tax is related to the selling price of the product. In modern production technology raw material passes through various stages and processes till it reaches the ultimate stage e.g., steel ingot are made, in a steel mill. These are rolled into plates by a re-rolling mill/unit, while the next manufacturer makes furniture from these plates. Thus the output of the first manufacturer becomes the input for the second manufacturer, who in turn carries out further processing and supplies it to the third manufacturer. This process thus continues till a final product emerges. This product then goes to the wholesaler/distributors, who sales it to the retailer and then it reaches to the ultimate customer.

If a tax is based on selling price of a product, the tax burden goes on increasing as raw material and final product passes from one stage to another. For example, let us assume that tax on a product is 10% of selling price. Manufacturer 'A' supplies his output to 'B' at Rs.100. Thus, 'B' gets the material at Rs.110 inclusive of tax @ 10%. He carries out further processing and sells his output to 'C' at Rs. 150 calculating his cost, 'B' has considered his purchase cost of materials as Rs. 110 and added Rs.40 as his conversion charges. While selling product to 'C' 'B' will charge tax again @ 10%. Thus, 'C' will get the item at Rs.165 (150+ 10% tax). As stages of production and/or sales continue, each subsequent purchaser has to pay tax again and again on the material which has already suffered tax. This is called cascading effect.

VAT was developed to avoid cascading effect of taxes. In the aforesaid example, "Value Added" by 'B' is only Rs.40 (150-110), tax on which would have been only Rs.4, while tax paid was Rs.15. In VAT, the idea is that 'B' will pay tax on only Rs.40 i.e. Value added by him. Then, it makes no difference whether a product passes through 5 or 10 stages, as every person will pay tax only on "Value Added" by him to the product and not on total selling price. VAT is a tax credit system, under which credit is given at each stage of tax paid at earlier stage.

(b) Service Tax: The provision to Service Tax were brought into force with effect from 1st July, 1994 to whole of India except the state of Jammu & Kashmir. The services, brought under the tax net in the year 1994-95 were Telephone, Stockbroker and general Insurance. Under section 65(105) of Finance Act, 1994. The Finance Act(2) 1996 enlarged the scope of levy of Service Tax covering three more services viz, Advertising agencies, courier agencies and Radio pager services. The Finance Act of 1997 and 1998 further extended the scope of service tax to cover a larger number of services rendered by service providers like- consulting engineer, custom house agents, steamer agents, clearing and forwarding agent, Air travel agent, Tour operators, Govt. of India notified imposition of Service Tax on twelve new services in 1998-99 Union Budget. These services were-Architects, Interior Decorator, Management Consultants, Practicing Chartered Accountants, Practicing Company Secretaries, Practicing Cost Accountants, Real Estate Agents/Consultants, Credit Rating Agencies, Private securities Agencies, Market Research Agencies and underwriters Agencies etc. In the Budget 2002-2003, 10 more services have been added to the tax net. In the Budget of 2003-2004 to 2005-2006, more and more services brought under the service tax net, the service tax revenue would now form a major part in Govt. Revenue earnings. Service Tax is administered by the Central Excise Commissioners working under the Central Board of Excise and Customs, Department of Revenue, Ministry of Finance, Govt. of India. Further an education cess of 2% of Service tax has been imposed vide section 95 of the Finance Act, 2004. System of self-assessment of Service Tax Returns by Service Tax assesses has been introduced w.e.f. 01.04.2001. The jurisdictional superintendent of Central Excise is authorized to cross verify the correctness of self-assessed returns. Tax returns are expected to be filed half yearly.

(c) Desk Review of EA-2000 Audit: Central Board of Excise and customs vide a circular issued in November, 2005 has decided to take up the help of Practicing Chartered/Cost Accountants in the Desk Review of EA-2000 Audit. This consists as first step of gathering advance information about assessee from departmental records published documents like Balance Sheet, annual statements etc., analysis of returns submitted by the assessee, Cost audit report collecting other details from assessee and through enquiries and identifying areas where revenue leakage is possible. This helps in finalizing audit plan, so that concentration can be made in those areas during audit. Thus Desk Review helps in concentrating audit efforts on major areas. Offer of "Desk Review" to Cost Accountant is an acknowledgement of his skills and knowledge in indirect taxes. Industries will also except Cost Accountants to guide them in submission of these returns so that they can answer audit queries properly. Desk Review will open a new field for practice by a Cost Accountant from department side as well as assessee side. Through Desk Review, the audit team decides the areas where it will concentrate during audit i.e., possible area of revenue leakage. At the Desk Review stage, there is only scrutiny of returns and records available with department. There is no contact with assessee at that stage. As per the circulars issued, Chartered Accountant will study ER-4 returns while Cost Accountant will scrutinize ER-5 and ER-6 returns. He will have to study assessee's master file available with the excise department, other returns submitted by the assessee, Balance Sheets, Cost Audit Report, audit report u/s 44AB of Income Tax Act, his past records etc. to enable him to take an overall view of the business of the assessee and possible revenue leakages.

There is no doubt that the Cost Accountant should possess adequate knowledge of excise-law-particularly Valuation and Cenvat - so that he can do a good job of a "Desk Review".

(d) Management Audit Programme:

- 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 a 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.

41.(a) Six areas where disputes in determining the assessable value of the goods for excise duty liability may arise. (b) A check list for carrying out an audit under section 14AA of the Central Excise Act.

(a) The following are the common areas in which disputes in determining the assessable value for excise duty commonly arise:

- (i) Types and quantum of deduction to be claimed for arriving at the assessable value,
- (ii) Existence of different classes of buyers and its effect on the value of the goods.
- (iii) Sales through depots as against sales from the factory gate.
- (iv) Sales through interested persons
- (v) Valuation of captively consumed goods.
- (vi) Valuation under job work.
- (vii) Valuation for determining the exemption limit of SSI Units.

(b) Check list for carrying out an audit under section 14AA of Central Excise Act are as follows:

- (i) Name of the industry and the method of costing adopted.
- (ii) Principal raw materials used, the input/output ratio norms established for the industry/company.
- (iii) Percentage of wastage/scrap/loss - standard and actual for the previous five years.
- (iv) Value of inputs for which Cenvat has been availed/ utilized vis-a-vis the value of inputs actually consumed for production.

- (v) In the case of consumables for which Cenvat has been availed, whether expenses charged to revenue are gross or net of Cenvat.
- (vi) Procedures adopted for payment of duty on good sends to sub-contractors/ other factories of the assessee.
- (vii) In case of Capital Goods for CENVAT availed - whether depreciation has been claimed on the element of Cenvat included in the cost of Capital Goods.

42. (a) Causes and Symptoms for Industrial Seekness; (b) Energy Conservation; (c) Describe qualities and function of a Management Auditor & (d) SWOT Analysis.

(a) Causes and Symptoms for Industrial Seekness: A company is declared as a seek industrial company if it incurs cash losses continuously for three years. Some of the major causes and symptoms of seekness are as follows:-

(1) Internal Causes:

- i. Inadequate technical know-how/outdated production process.
- ii. High cost of inputs.
- iii. Over estimation of demand for the product/ under estimation of requirement of working capital.
- iv. Dependents on a single or a small number of customers.
- v. Defective pricing policy.
- vi. Diversion of funds.
- vii. Incompetent/dishonest management.

(2) External Causes:

- i. Product obsolescence.
- ii. Infrastructure bottlenecks/chronic power shortage.
- iii. Natural calamities/Political uncertainties.
- iv. Sudden changes in Government policies.

(3) Symptoms of Seekness:

- i. Low capacity utilization.
- ii. Larger and longer outstanding.
- iii. Default in payment of statutory liabilities.
- iv. Continuous irregularity in cash credit account.
- v. Diversion of working capital funds.

(b) 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.

(c) Desirable qualities and function of a Management Auditor:

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

- i. Ability to grasp the business problems.
- ii. General understanding of the motive, purpose and objectives of the organization to be audited.
- iii. Knowledge about the basic management principles and practices.
- iv. Sufficient knowledge about Engineering, Statistical techniques, Cost and Management Accountancy, Production planning and control.
- v. General understanding of various laws like Company Law, Customs, Central Excise, Income Tax, MRTP, FEMA etc.
- vi. Ability to prepare reports for different levels of management.
- vii. Ability to move and get along with all people at different levels.
- viii. Effective communicator with ability to elicit information.

Functions of a Management Auditor:

- i. He should ensure that all pertinent information needed for planning reaches the higher management.
- ii. He should ensure that the decisions are based on the objectives of the management.
- iii. He should focus maximum attention on functions/operations, which are profit making/ revenue yielding.
- iv. 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.
- v. The implication of changes in the budgetary proposals should be projected by him adequately both in respect of direct and indirect taxation.
- vi. Assist the management in achieving the most efficient and effective administration.

(d) 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.

43. (a) The 'Records' are considered as part of the Cost Accounting under Sec. 209(1) (d); (b) Review-should be made by a Cost Auditor of Cost Accounting Records.

(a) The following records are considered as part of the Cost Accounting records:

- (1) Production.
 - Consumption resister of raw materials, packing materials, etc.
 - Production Report
 - Scrap, Wastages, Spoilage and defective report and material reconciliation etc.
 - Machine Utilization Report and Idle Time Report.
 - Details of Production Hours, Labour Hours and Machine Hours
 - Other related matters of production, if any.
- (2) Raw Materials, Stores etc.
 - Goods received resisters
 - Bin Cards and Stores Ledger
 - Material Consumption and Stock Reports
- (3) Utilities (Steam, Power and Water etc.)
 - Records of Inputs and Outputs
 - Records of cost centre wise allocation of products
 - Records for own generated power and purchased power
- (4) Wages and Salaries including benefits
 - Attendance resisters
 - Payroll
 - Leave Wages and gratuity payments, VRS payment etc
 - Overtime and Idle Time records
- (5) Overheads:
 - Overheads analysis/ distribution resisters
 - Overhead absorption details
- (6) Repairs and maintenance
 - Work order resister
- (7) Work-in-progress and Finished Goods
 - Cost Centre wise/ product wise stock resister
 - Product wise Finished Goods resister
- (8) Cost Accounts records and statements
 - Cost centre wise assets register
 - Product Ledger
 - Annexure and proforma as per Cost Accounting Record Rules
 - Reconciliation of profit/loss as per financial records
- (9) Sales
 - Sales register including export sales resister
 - Sales analysis of by-products (quality, size etc.)
- (b)
The Cost Auditor during the course of audit will thoroughly review the cost accounting records as follows:
 - (1) Method of costing in use- Batch, Job, Process etc.
 - (2) System of fixation of cost centres.
 - (3) Procedures for accounting of materials and spares etc.
 - (4) Methods of accounting of wastages, rejections and defectives.
 - (5) System of recording of wages, salaries and overtime and their allocation.
 - (6) Incentive schemes in vogue.
 - (7) Basis of allocation/apportionment of utilities.
 - (8) Method of accounting of depreciation and charging depreciation to cost centres.
 - (9) Method of apportionment of Service Department Expenses to Production Department
 - (10) Basis of absorption of overheads to products.
 - (11) Basis of absorption of interest, bonus, gratuity and selling and distribution overheads
 - (12) Budgetary control system
 - (13) Internal audit system

- (14) Method of accounting of production and sales
- (15) Treatment of research and development expenses
- (16) Checking of Type/size/product wise cost sheet with PROFORMA for statement showing the cost of production, cost of sales, sales realization and margin in respect of products under reference produced during the year/period.

44. The basic differences between any two out of the following: (a) Inventory Audit and Audit under section 14AA of the Central Excise Act; (b) Voluntary Cost Audit and Internal Audit; (c) Sales and Marketing.

(a) Inventory audit involves the following aspects:-

- (i) Physical verification of stock
- (ii) Methods of valuation adopted
- (iii) Currency of stock (i.e. movement)

Under section 14AA of the Central Excise Act the purpose of audit is to find out that the credit of duty availed of or utilized is not within normal limits having regard to the nature of the excisable goods produced, the types of inputs used and other relevant factors,

(b) Cost audit is need not necessarily be ordered by Government. Many organizations feel the need to have the audit done every year or even before the period of commencement as per law. Cost audit is conducted under the report for voluntary cost audit. Internal audit is conducted for internal checking all the areas of the concern. The appointment of internal audit is made by the management of the concern and report is submitted to the management.

(c) Sales covers execution of order and collection of money from customers, whereas marketing creates the demand for the product by advertising and other marketing techniques. Sales are one of the Marketing area.

45. SWOT analysis & Social Responsibility Management.

The different types of pollution for which a manufacturing company is responsible.

(a) 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.

(b) 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:-

- i. Air Pollution - caused by burning or letting out of chemicals in the air leads to respiratory diseases.
- ii. Water Pollution - caused by letting out of effluents in water bodies or agricultural lands by industries like Tanneries, Dyeing units etc., result in contamination of ground water making it unsuitable for human consumption and in pollution of quality of soil affecting agriculture.
- iii. Noise Pollution - by the running of heavy industries water well drilling etc. lead to loss of hearing and psychological disorders.
- iv. Thermal or Climate Pollution - caused by excessive heat generated in the manufacturing process will affect the environment resulting in deforestation or stunted plant growth.
- v. Radiation Pollution - caused by Nuclear Power Plants will affect the health of the people living in the vicinity.

46. (a) The purpose of the audit prescribed under Sec. 14AA of the Central Excise Act; (b) The possible areas for misuse/malpractice; (c) A checklist for carrying out an audit under Sec. 14AA of the Central Excise Act. (a) The purpose of audit under section 14AA of Central Excise Act is to find out the reasons of fraud when the Commissioner of Central Excise has reason to believe that the credit or duty availed of or utilized under the rules by a manufacturer is not within the normal limits.

(b) Possible areas for misuse/ malpractice are as follows:-

- i. Showing consumption of inputs higher than the norms and corresponding higher wastage/scrap.
- ii. Claiming CENVAT on inputs used for production of goods exempted from duty.
- iii. Claiming depreciation on the CENVAT element included in the value of capital goods.
- iv. Claiming CENVAT on capital goods which are specifically excluded.

(c) Check list for carrying out an audit under section 14AA of Central Excise Act are as follows:

- i. Name of the industry and the method of costing adopted.
- ii. Principal raw materials used, the input/output ratio norms established for the industry/company.
- iii. Percentage of wastage/scrap/loss - standard and actual for the previous five years.
- iv. Value of inputs for which CENVAT has been availed /utilized vis-a-vis the value of inputs actually consumed for production.
- v. In the case of consumables for which CENVAT has been availed, whether expenses charged to revenue are gross or net of CENVAT.
- vi. Procedures adopted for payment of duty on goods sent to subcontractors/other factories of the assessee.

47. (a) Energy Audit; (b) Audit Committee; (c) Industrial Sickness; (d) Management Frauds.

(a) Energy Audit: Energy Audit means the monitoring of the effective utilization of energy by different equipments & processes in a plant and suggesting ways and means of reducing the overall energy consumption. It covers all types of energy such as electrical energy, fuel such as oil, gas, coal, firewood, bagasse.

(b) Audit Committee: Audit Committee is set up by the company and their details are as follows:-

- i. The audit committee shall have minimum three members.
- ii. The chairman of the committee shall be an independent director.
- iii. The chairman of the committee shall be present at Annual General Meeting to answer share holder's queries.
- iv. The company secretary shall act as the secretary of the committee.
- v. The audit committee shall meet at least thrice a year.
- vi. The audit committee shall have powers as follows:-
 - To investigate any activity.
 - To seek information from an employee.
 - To obtain outside legal or other professional advice.

(c) Industrial Sickness: A company is declared as a sick industrial company if it incurs cash losses continuously for 3 years. Some of the major causes and symptoms of sickness are as follows:-

(i) Internal causes:

- ia. Inadequate technical know-how/outdated production process.
- ib. High cost of inputs.
- ic. Overestimation of demand for the product/under estimation of requirement of working capital.
- id. Dependence on a single or a small number of customer.
- ie. Defective pricing policy.
- if. Diversion of funds.
- ig. Incompetent/dishonest management.

(ii) External causes:

- iiia. Product obsolescence.
- iiib. Infrastructural bottlenecks/ chronic power shortages.
- iiic. Natural calamities/political uncertainties.
- iiid. Sudden changes in Government policies.

(iii) Symptoms of sickness:

- iiia. Low capacity utilization.
- iiib. Larger and longer outstanding.
- iiic. Default in payment of statutory liabilities
- iiid. Continuous irregularity in cash credit account.
- iiie. Diversion of working capital funds.

(d) 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.

48. In spite of increase turnover, continuously for three years, a company has started incurring cash losses, and has become sick. The factors which have led to this situation from the Cost Audit Report and the relevant paragraphs in the Annexure to the Report.

Factors to be considered for the followings:

- a. Turnover of the Company is increasing continuously for three years.
- b. Still company is incurring cash losses and became sick.

Following are various Annexure of Cost Audit Report which will provide explanation about Company's position.

(1) Para 5(A) - Raw Materials Consumption This will help in finding comparison of quantities used and price that is paid for materials:

- a. Indigenous
- b. Imported
- c. Self-Manufacture

Increase in Raw Material prices may be reason for more expenditure.

(2) Para 5(B) - Raw Material Usage

In this Para Standard Consumption and Actual Consumption is highlighted and also usage inefficiency is focused.

(3) Para 6 - Imported Raw Material

In this Para the details of imported price is highlighted.

(4) Para 7(A) - Consumption of Power & Fuel: This Para give details of Power & Fuel consumption of Electricity Purchased, Electricity Generated, HSD Oil, Gas etc.

(5) Para 7(B) - Usage of Power & Fuel: This Para highlight the actual usage and standard consumption of Electricity per unit of Production and similarly of HSD Oil, Gas etc

(6) Various Expenses: Following are various Paras which will provide details of various expenses incurred for producing the product. The figures are provided for Current Year and Previous Two Years which enable to judge increase in expenses.

Para 8: Salaries & Wages of Direct, Indirect, Administrative and Others

Para 9: Repairs & maintenance of Building of Office, Staff Quarters, Plant & Machinery and others.

Para 12: Overheads which consists of Factory, Administrative, Selling and Distribution

Para 13: Research & Development.

Para 14: Royalty

Para 15: Quality Control

Para 16: Pollution Control

(7) Para 17 - Abnormal Expenses: This Para deals of abnormal expenditure incurred during the year in respect of Strike, Lockout, Breakdown of Machinery and Stoppage of work due to Power Cut, Shortage of Raw materials, Absenteeism etc.

(8) Para 20 - Sales: This is important Para for analysis and ultimate result of the concern. In this Para the figures are highlighted of (a) Domestic and (b) Export Sales.

(9) Para 21 - Sale Margin: This is also important Para for analysis. This will highlight profitability of the Company by (a) Product wise and (b) Region wise. This will also help in finding whether there is an adverse change in product mix.

After analysis of the all the above Annexure causes for decline in Profit and increase in losses can be found out and some of them are mentioned below:

- i. There may be adverse change in product mix so that though there is increase in Sales Volume but contribution is reduced.
- ii. There may be increase in Expenses which might be due to -
 - (a) Increase in Rates
 - (b) Inefficiency in use
- iii. Change in Credit Period - Though there is increase in Sales Volume which is due to increase in Credit Period. This might have resulted in increase in Interest cost.
- iv. Capital expenditure - The concern has incurred huge capital expenditure where benefit is less than cost incurred in initial period.

After studying the actual facts, correct analysis is possible.

49. (a) Required information is to be furnished by the Cost Auditor in the "Annexure to the Cost Audit Report", and "Observation and Suggestion" in regard to exports, if any, of the product under audit. (b) Abnormal/Non-recurring Costs to be treated in Cost as per Para 17 of the Annexure to the Cost Audit Report Rules, 2001. Give illustration of such Costs.

(a) Cost Auditor should furnish in his Cost Audit Report Rules, 2001, as follows: -

1. In Para 20, separate details should be furnished for exports. There may be three situations which have to be regarded as Export Sales:
 - a. Transactions in which the goods supplied leave the country and the sales value is realized/ realizable in foreign currency.
 - b. Transactions in which the goods supplied do not leave the country and the sales value is realized, realizable in Indian rupee, (deemed exports)
 - c. Transactions in which the goods supplied leave the country and the sales value is realized/ realizable in Indian rupee.
2. In Para 21, "Margin per unit of output" in respect of Export of Sales to be provided. In this Para separately will be given for Type-wise/Country-wise of Cost of Sales, Sales Realisation and Margin which will tally with Proforma.
3. In Para 22, "Competitive Margin against imports" states in Sl. No 7(c) Cost of prod./units (Export sale) and in Sl. no.7(d) Cost of sales,/ unit (Export sale).
4. Cost Auditor in his observations and suggestions also state the Export commitments of the Company vis-à-vis actual exports for the year under review. Also comment on comparative profitability and pricing policy of the company for domestic and export sales. The auditor also suppose to give impact of exports benefits/incentives offered by the Government on export profitability.

(b) As a normal costing practice, normal and recurring expenditure alone should be charged to cost of units produced and abnormal and non-recurring expenditure which are generally charged to Costing Profit and Loss Account and not booked to the Cost of Product.

The followings are the illustrations of the situations when abnormal cost may arise as follows:-

- i. Scarcity of Raw Materials
- ii. Strikes, lockout
- iii. Major breakdowns in the Plant
- iv. Substantial power cuts
- v. Serious accidents

Situation under normal conditions giving rise to abnormal non-recurring cost are as follows.

- i. Absorption of New technology
- ii. Introduction of new products
- iii. Commissioning of new machines or plants

In the above cases, the production may not yet be stabilized and considerable wastages of material inputs may incurred as the organization may still be the beginning of learners. The figures to be presented under this Para