

FINAL EXAMINATION-STAGE IV

JUNE 2011

PAPER 17: COST AUDIT & OPERATIONAL AUDIT

Answer Question Nos. 1 & 5, which are compulsory and any two each from the remaining questions of Section I and II

SECTION I (50 Marks)

1. (a) State whether the following statements based on the quoted terms are "TRUE" or "FALSE", with justifications for your answer. If any statement is "FALSE", you are required to give the correct terms duly quoted. No credit will be given for any answer without justification :
- (i) Cost Audit Order is Product specific.
 - (ii) Para 17 of the Annexure to the Cost Audit Report on Abnormal Non-recurring Costs provides information for the current year and the previous year.
 - (iii) Power Transformers are covered by Cost Accounting Records (Electric Cables and Conductors Rules).
 - (iv) CAS 9 deals with Indirect Material Cost.
 - (v) As per CAS 12, fines, penalties, damages and similar other levies paid to statutory authorities or third parties shall form part of Repairs and Maintenance Cost. 1x5
- (b) Choose the correct answer :
- (i) Rectified spirit is covered by
 - (a) Cost Accounting Records (Chemical Industries) Rules
 - (b) Cost Accounting Records (Formulations) Rules
 - (c) Cost Accounting Records (Industrial Alcohol) Rules
 - (d) Cost Accounting Records (Bulk Drugs) Rules
 - (ii) Each major materials for which details to be furnished as per Annexure to the Cost Audit Report Rules should constitute
 - (a) 10% of the Raw Material Cost
 - (b) 2% of the Raw Material Cost
 - (c) 5% of the Raw Material Cost
 - (d) 1% of the Raw Material Cost
 - (iii) A Tea Company has twelve garden located at different places and regarded as separate Unit. How many maximum number of Firm can be appointed?
 - (a) Two Firms as joint auditors
 - (b) Twelve Firms as joint auditors
 - (c) Six Firms as joint auditors
 - (d) One Firm for Twelve gardens

- (iv) Copy of Cost Audit Report need not be submitted to
 (a) Company Law Board
 (b) Board of Directors of the Company
 (c) Members at Annual General Meeting of the Company
 (d) Income Tax Officer
- (v) According to CAS 2 on Capacity Determination, "Normal Capacity" is
 (a) Practical capacity minus the loss of production capacity due to external factors.
 (b) Difference between installed capacity and the actual capacity utilization
 (c) Maximum production capacity of a plant
 (d) Installed capacity minus the inevitable interruptions
- (c) Fill in the blanks with appropriate word / words :
 (i) GASAB stands for _____ in India.
 (ii) Non-moving Stock is being dealt with in Annexure to the Cost Audit Report Rules vide _____
 (iii) Cost Audit was initially introduced in the year _____
 (iv) According to CAS 8 on utilities the cost of maintaining stand-by utilities is _____ 1x4 cost.

Answer to Question No.1(a)

- (i) True : A company need not have Cost Auditor for the product not specified in the order.
 (ii) False : Information is to be provided for current year and previous two years.
 (iii) False : Power Transformers are covered by Cost Accounting Records (Engineering) Rules.
 (iv) False : CAS 9 deals with Packing Material Cost.
 (v) False : Fines, Penalties, Damages and similar other levies are purely of financial nature and do not form part of Repairs and Maintenance Cost.

Answer to Question No.1(b)

- (i) (c) (3) Cost Accounting Records (Industrial Alcohol) Rules.
 (ii) (b) (2) 2% of the Raw Material Cost.
 (iii) (b) (2) 12 Forms as joint auditors.
 (iv) (c) (3) Members at Annual General Meeting of the Company.
 (v) (a) (A) Practical capacity minus the loss of production capacity due to external factors.

Answer to Question No.1(c)

- (i) GASAB stands for Government Accounting Standard Advisory Board.
 (ii) Para 18A.
 (iii) 1965.
 (iv) Committed.

2. (a) List the duties to be performed by a Cost Auditor. 6
 (b) The following figures are extracted from the statement prepared by the Cost Accountant and the Trial Balance of XYZ Ltd., which is a single product company.

	Year Ending		
	31.3.11	31.3.10	31.3.09
	(Rs. In Lakhs)		
Gross sales inclusive of Excise Duty	2,040	1,985	1,875
Excise Duty 295	280	265	
Raw Materials consumed	1,140	1,060	975
Direct Wages	35	32	27
Power and Fuel	30	27	24
Stores and Spares	6	5	4
Depreciation charged to production cost centres	16	15	13
Factory overheads :			
Salaries and Wages	5	4	3
Depreciation	2	2	2
Rates and Taxes	1	1	1
Other Overheads	6	5	4
Administrative overheads :			
Salaries and Wages	10	9	8
Rates and Taxes	2	2	2
Other overheads	165	154	148
Selling and Distribution overheads :			
Salaries and Wages	7	6	5
Packing and Forwarding	6	6	5
Depreciation	1	1	1
Other overheads	124	118	108
Interest 85	74	68	
Bonus and Gratuity	12	10	9
Gross Current Assets	840	724	640
Current Liabilities and Provisions	324	305	246

You are required to compute the following ratios as per requirement of para 24 of the Cost Audit Report Rules, 2001 :

- (I) Operating Profit as percentage of Value Addition.
- (II) Value Addition as percentage of Net Sales.

Note : The computation should be based on EBDIT as operating profit.

6+6

Answer to Question No.2(a)

The duties to be performed by a Cost Auditor are as listed below :

- i. To ensure that the proper books of accounts as required by Cost Accounting Record Rules have been kept by the company and proper returns for the purpose of his audit have been received from branches not visited by him.

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- ii. To ensure that the Cost Audit Report and the detailed cost statements are in the form prescribed by the Cost Audit Report Rules by following sound professional practices, i.e., the report should be based on verified data and observations may be framed after the company has been afforded an opportunity to comment on them.
- iii. The underlying assumptions and basis for allocation and absorption of indirect expenses are reasonable and are as per the established accounting principles.
- iv. If the auditor is not satisfied in any of the aforesaid matters, he may give a qualified report along with the reasons for the same.
- v. He is to send the Cost Audit Report to the Cost Audit Branch within 180 days from the end of the financial year with one copy to the company.
- vi. He is required to send his replies to any clarification, that may be sought by the Cost Audit Branch on his report. The Auditors reply should be sent within 30 days from the date of receipt of communication calling for such clarification.

Answer to Question No.2(b)

	Year Ending		
	31.3.11	31.3.10	31.3.09
Gross sales inclusive of Excise Duty	2,040	1,985	1,875
Excise Duty	295	280	265
Net Sales (A)	<u>1,745</u>	<u>1,705</u>	<u>1,610</u>
Cost of Sales excluding Depreciation & Interest:-			
Raw materials consumed	1,140	1,060	975
Direct Wages	35	32	27
Power and Fuel	30	27	24
Stores and Spares	6	5	4
Factory overheads (excluding depreciation)	12	10	8
Administrative overheads (excluding depreciation)	174	165	158
Selling and Distribution Overheads (excluding depreciation)	137	130	118
Bonus and Gratuity	12	10	9
Total (B)	<u>1,546</u>	<u>1,439</u>	<u>1,323</u>
Operating Profit (A) – (B) =	<u>199</u>	<u>266</u>	<u>287</u>

Value addition is defined in Para 3 (b) of the Cost Audit (Report) Rules, 1996 as "the difference between the net output value (Net Sales) and cost of bought out materials and services for the product under reference". Alternatively in Para 23 of the Cost Audit (Report) Rules, 2001, in Item No. A value addition has also been defined as mentioned above.

The working will be :

	Year Ending		
	31.3.11	31.3.10	31.3.09
	(Rs. in Lakhs)		
(X) Net Sales	1,745	1,705	1,610
Less:			
(i) Cost of bought out materials and service (Raw materials and Stores & Spares)	1,146	1,065	979
(ii) Power & Fuel, other bought out services	30	27	24
(iii) Overheads (excluding salaries & wages, rates & taxes and depreciation)	298	283	265
(Y)	1,474	1,375	1,268
Value addition : (X) – (Y)	271	330	342
Hence			
(a) Operating profit as % of Value Added	199/271 (73.43%)	266/330 (80.6)%	287/342 (83.92)%
(b) Value addition as % of Net Sales	271/1745 (15.53%)	330/1705 (19.35%)	342/1640 (21.24%)

3. (a) State the areas of applicability of Cost Accounting Record Rules.

6

(b) The profit as per financial accounts of XY Cement Ltd., for the year 2010-11 was Rs.1,34,27,561. The profit as per Cost Accounting Records for the same period was more. You are required to prepare a reconciliation statement and arrive at the profit as per Cost Accounts. The following details are collected from the financial accounting schedules and cost accounting records.

Particulars	Financial Accounts	Cost Accounts
Value of Stock :	29,52,315	23,45,720
Opening : WIP	2,48,37,410	2,72,16,930
Finished Goods	41,72,635	36,36,345
Closing : WIP	3,67,51,400	4,15,24,148
Finished Goods	6,14,250	-
Interest income from inter-corporate deposits	4,75,250	-
Donations given	1,04,148	-
Loss on sale of fixed assets	3,75,920	3,45,200
Value of cement taken for own consumption		
Cost of power drawn from own wind-mill :		48,58,415
- At EB Tariff	34,10,420	
- At Cost		

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Answer to Question No.3(a)**Cost Accounting Records Rules and its Applicability**

- i. The Cost Accounting Records Rules are applicable only to selected companies incorporated under the Companies Act, 1956 (whether private or public) and not to other forms of business such as partnership, proprietary, etc.
- ii. A wholly owned subsidiary of a company, to which Cost Accounting Records Rules are applicable is also covered by the said record rules provided that the product of such subsidiary company forms a part/component of cost of production of the product or use of utility/services for the holding company.
- iii. In the case of company manufacturing a product covered by the record rules but the said product is entirely used as in-house input (captive consumption) for another end product not covered, it may be clarified that the relevant Cost Accounting Records Rules are applicable to such product (produced but not sold) and prescribed records have to be maintained with respect to said product under reference.
- iv. Small scale units are generally exempted from the requirements of Cost Accounting Records Rules, even if they belong to the industries or class of companies for which, the maintenance of Cost Accounting Records have been prescribed.
- v. The existing limit for the aggregate value of the installed plant and machinery on the last date of the preceding financial year is Rupees One Crore for being categorized as a small scale unit. However, it may be clarified that in case of companies manufacturing "formulations", covered under Drug Price Control Order, small scale units are also covered under the provisions of Cost Accounting Records Rules.

"formulations", covered under Drug Price Control Order, small scale units are also covered under the provisions of Cost Accounting Records Rules. 6

Answer to Question No.3(b)**Reconciliation of Financial Profit and Costing Profit**

(Figures are in Rupees)

Profit as per Financial Accounts		1,34,27,561
Add: Difference in Stock Valuation	24,62,533	
Loss on sale of fixed assets	1,04,148	
Donation not considered in cost accounts	4,75,250	30,41,931
		1,64,69,942
Less: Interest income from Inter-corporate deposits	6,14,250	
Difference in value of cement taken for own consumption	30,720	
Difference in valuation of windmill power	14,47,995	20,92,965

Profit as per Cost Accounts (1,64,69,942 – 20,92,965) = Rs.1,43,76,527

Note: Computation of difference in valuation of Stock

Financial A/C & Cost A/C		
Opening (WIP + FG)	2,77,89,725	2,95,62,650
Closing (WIP + FG)	4,09,24,035	4,51,59,493
Increase in Closing Stock	1,31,34,310	1,55,96,243

The Increase is higher in Cost Accounts and hence the Cost Accounts Profit would be more than the Financial Accounts Profit by (Rs.1,55,96,843 – 1,31,34,310), i.e., Rs.24,62,533. –

OR

Profit as per Financial A/C (2010-11)

1,34,27,561

Add:

(1) Difference in valuation of stock (WIP & F/Goods)

Valuation between Financial Accounts & Cost Account

	<u>Financial Accounts</u>	<u>Cost Accounts</u>
(i) Opening Stock WIP	29,52,315	23,45,720
Closing Stock WIP	41,72,635	36,35,345
Closing Stock of WIP is more in both the A/C	12,20,320	12,89,625
Closing Stock of WIP is more in cost A/Cs than Financial A/Cs (1289625 – 1220320)		69,305

(2) Difference in valuation of stock in both the A/Cs of Finished Goods

(b) Opening Stock of F/Goods	2,48,37,410	2,72,16,930
Closing Stock of F/Goods	3,67,51,400	4,15,24,148
Closing stock valuation is more in Cost A/C	<u>1,19,13,990</u>	<u>1,43,07,218</u>

(ii) (143,07,218 – 119,13,990)

23,93,228

Total difference in valuation of WIP & F/Goods is more in Cost A/Cs (a+b)
(69,305 + 23,93,228)

24,62,533*

1,04,148

4,75,250

(2) Loss on Sale of Fixed Assets

30,41,931

(3) Donations not considered in Cost Accounts (1+2+3)

(1+2+3) (+) 30,41,931
1,64,69,492

Less: (1) Interest Income from Inter-corporate deposits

6,14,250

(2) Value of Cement taken for own consumption (3,75,920-3,45,200)

30,720

(3) Cost of Power drawn from own wind mill

- At EB Tariff

48,58,415

- At Cost

34,10,420

14,47,995

(-) 20,92,965

(1) + (2) + (3)

1,43,76,527

PROFIT AS PER COST ACCOUNTS

COST ACCOUNTS PROFIT IS MORE (1,43,76,527-1,34,27,561) = 9,48,966

OR

Reconciliation of Financial Profit and Costing Profit

Figures are in Rs. (2010-11)
134,27,561

1. Profit as per Financial Accounts

2. (a) Add: Difference in Stock Valuation

Opening Stock

Financial A/Cs

Cost A/Cs

WIP

29,52,315

23,45,720

Finished Goods

2,48,37,410

2,72,16,930

2,77,89,725

2,95,62,650

Closing Stock

41,72,635

36,35,345

WIP

3,67,51,400

4,15,24,148

Finished Goods

4,09,24,035

4,51,59,493

Add: Closing Stock

4,09,24,035

4,51,59,493

Less: 2,77,89,725

2,95,62,650

(A) 1,31,34,310(B) 1,55,96,843

(B) - (A)

1,55,96,843

1,31,34,310

+24,62,533

+24,62,533*

1,58,90,094

(b) Loss on Sale of Fixed Assets

1,04,148

(c) Donation and considered in Cost A/Cs

4,75,250

+5,79,398

30,41,931

(1+2) or (a) + (b) + (c)

1,34,27,561

30,41,931

1,64,69,492(3)

Less:

3. (a) Interest Income from Corp A/C

6,14,250

3. (b) Value of Cement taken for own consumption
(3,75,920 - 3,45,200)

30,720

3. (c) Cost of Power drawn from own Wind Mill

- At EB tariff

48,58,415

- At Cost

34,10,42014,47,995(-)20,92,965

Profit as per Cost Accounts

Rs. 1,43,76,527

(B) Cost A/Cs Profit is more by (+) 24,62,533*

*in opening stock of WIP & Finished Goods
& Closing stock of WIP & Finished Goods

4. (a) Write a brief note on 'Cost Accounting Standards'.

6

(b) Differentiate between Cost Accounting Standards and Cost Accounting Record Rules.

6

(c) Discuss the requirements relating to the following in the Cost Accounting Records Rules :

(i) Salaries and Wages.

(ii) Depreciation.

(iii) Royalty and Technical know-how.

(iv) Research and Development Expenses.

(v) Related Party Transactions.

(vi) Pollution Control

1x6

Answer to Question No. 4(a)

Cost Accounting Standards (CAS) are a set of standards that are designed 'to achieve uniformity and consistency in cost accounting practices'. Uniform Cost Accounting Standards shall provide greater uniformity in Cost Accounting as a basis for negotiating and administering procurement contracts.

In the absence of uniform costing methodologies or disclosure requirements, no meaningful inter-firm comparison can be made as to the reasonability of the claims made by the units in the industry.

Government has embarked upon major reforms during last two decades. Private Sector has been introduced in social, infrastructural and health and welfare sector also, with built-in flexibility to recover their costs with reasonable profits. Private sector has already come out in a very big way in 'education sector'. It is therefore, very pertinent that appropriate laws are framed to avoid malpractices and to ensure that this flexibility is not misused and public at large is not made to pay exorbitant prices for availing or using these facilities. The absence of Cost Accounting Standards provides a scope for various malpractices, reducing the impact of overall objectives. Mandatory Cost Accounting Standards are already in place in other developed countries. There is a need for mandatory Cost Accounting Standards in India.

The liberalization in the country needs simple, transparent and flexible rules to enable the Government Organizations / Departments early procurements / services at competitive costs without going into cumbersome procurement process. Therefore, many developed countries have issued uniform guidelines for small value projects.

Further Cost Accounting Standards also ensure that more projects are completed in a timely manner as a result of the streamlined awards process and with reduction in paperwork.

Answer to Question No. 4(b)

Cost Accounting Standards vs Cost Accounting Record Rules

Presently, separate Cost Accounting Record Rules have been prescribed w.r.t. each class of industry or product covered under Section 209(1)d). Total 44 products have so far been covered under the respective Cost Accounting Record Rules. Even though the rules are broadly similar, yet there are definitely differences amongst various rules, especially in formats and in treatment of certain items of expenditure. Therefore, each rule has its own complexities. In any case, their coverage is limited to the selected companies only falling under 44 industries.

Cost Accounting Standards, on the other hand, shall be uniformly applicable to all the units, including companies and are easier to understand besides being flexible and uniform. Therefore these will have a much wider coverage.

Today, when most of the companies are multi-product organizations manufacturing or producing number of products, only one or two products only are generally covered under Cost Accounting Record Rules. Both of them are covered under different rules and it becomes difficult for the companies to comply with the requirements.

On the other hand, Cost Accounting Standards shall be equally applicable to the companies and all products manufacturers.

Therefore, many experts are of the view that prescription of Cost Accounting through Cost Accounting Standards with appropriate compliance audit or disclosure norms may be much more effective and useful than through complicated Cost Accounting Records Rule.

Answer to Question No. 4(c)

- i. **Salaries and Wages** : The company should maintain records of earnings of all employees. All direct wages and salaries should be charged to the respective cost centres. The cost idle time shall be recorded separately indicating the reasons thereof. Wages and salaries relating to capital works shall be excluded from the cost of production.
- ii. **Depreciation** : Records shall be maintained separately showing the specific block and apportioned block in respect of each item of asset. The basis on which depreciation is calculated and allocated or apportioned to various cost centres and absorbed on all products shall be clearly indicated in the cost records.
- iii. **Royalty and Technical know-how** : The adequate records shall be maintained showing the royalty and/or technical know-how fee including other recurring or non-recurring payments of similar nature if any, made for the products or activities under reference to collaborators or technology suppliers in terms of agreement entered into with them. The basis of charging such amount, including lump sum payment and its treatment shall be indicated in the cost records.
- iv. **Research and Development Expenses** : Records shall be maintained indicating the details of R&D expenses incurred by the company. The records shall also indicate the payments made to outside parties for the R&D work.
- v. **Related Party Transaction** : Records shall be maintained for all "Related party transactions, showing contracts entered into and the agreement or understanding reached. The records shall also indicate the basis followed for arriving at the rates charged or paid for such products or services.
- vi. **Pollution Control** : Expenditure incurred on various measures to protect the environment like effluent treatment, control of pollution of air, water, etc., should be properly recorded.

SECTION II (50 Marks)

5. (a) State whether the following statements based on the quoted terms are "TRUE" or "FALSE" with justification for your answer. If any statements is "FALSE", you are required to give the correct terms duly quoted. No credit will be given for any answer without justification.
 - (i) An Operational Audit is an extension of Financial Audit.
 - (ii) The concept of Management Audit was developed by T.G. Rose.
 - (iii) The term "Image" of a company refers to how it is perceived by the public at large.

- (iv) 'Due Diligence' is not a process of valuation of a business.
- (v) Central Excise is the single largest source of revenue through indirect taxes for the Central Government of India. 1x5

(b) Fill in the blanks with appropriate word / words :

- (i) _____ in banks traditionally implies transaction audit.
- (ii) EA 2000 is a _____ and interactive method of audit.
- (iii) The _____ is the highest body of WTO.
- (iv) Dumping occurs, if a company exports its product at a _____ price than the _____ price charged by it in the domestic market. 1x5
- (v) A profession is an _____ or career.

(c) What do the following abbreviations stand for ?

- (i) SOX
- (ii) PCAOB
- (iii) IFAC
- (iv) CAAB

1x4

Answer to Question No.5(a)

- i. True : The given statement is True.
- ii. True : The concept of Management Audit was indeed developed by T.G. Rose.
- iii. True : The given statement is True.
- iv. True : The given statement is True.
- v. True : The given statement is True.

Kindly note that even though in the Question Paper, it has been stated that no credit will be given for answers without justification, yet you are requested to give $\frac{1}{2}$ mark for the correct more True / False answers

Answer to Question No.5(b)

- i. Bank Audit in banks traditionally transaction audit.
- ii. EA 2000 is a modern, transparent and interactive method of audit.
- iii. The Ministerial Conference, is the highest body of WTO.
- iv. Dumping occurs, if a company exports its product at a lower price than the normal price charged by it in the domestic market.
- v. A profession is an occupation, vocation or career.

Answer to Question No.5(c)

- i. SOX : Sarbanes-Oxley
- ii. PCABO : Public Company Accounting Oversight Board.
- iii. IFAC : International Federation of Accountants.
- iv. CAAB : Cost Audit & Assurance Board.

6. (a) Given below are the abridged balance sheets and profit & loss account of AB Spinning Mills Ltd.:

	2009-10	2008-09	2007-08
	(Rs. In Lakhs)		
Balance Sheet :			
Share Capital	245	245	245
Reserves and Surplus	726	1,077	1,313
Long term borrowings	287	180	160
Working Capital Loans	1,639	451	672
Sundry Creditors	1,616	1,255	1,015
Other Provisions	389	315	305
Total	4,902	3,523	3,710
Net Block	1,009	541	621
Investments	19	19	19
Current Assets :			
Inventory	1,160	1,521	1,641
Bad Debts	11	114	172
Loans and advances	2,641	1,286	1,231
Cash and Bank Balances	62	42	35
Total	4,902	3,523	3,710
Profit and Loss Account:			
Sales	5,091	3,938	4,215
Other Income	446	365	342
Total	5,537	4,303	4,557
Raw materials, stores and spares consumed	3,728	2,775	2,964
Factory Wages	162	215	206
Salaries	377	322	295
Power and Fuel	826	673	710
Repairs and Maintenance :			
Buildings	7	18	15
Plant and Machinery	38	54	48
Vehicles	43	33	24
Depreciation :			
Buildings	11	14	16
Plant and Machinery	57	43	48
Vehicles	66	26	30
Interest	277	130	152
Other Overheads (excluding salaries & depreciation) :			
Factory Overheads	138	94	82
Administrative overheads	71	59	41
Selling & distribution overheads	87	83	80
Loss for the year	(-) 351	(-) 236	(-) 154
Total	5,537	303	4,557
Sales for the year (kgs)	4350890	3436921	3725405

The bankers to the company have appointed you as a Consultant for identifying the factors which have contributed to the continuing losses. Prepare a short note highlighting the factors which have prima facie led the company to sickness.

(b) Enumerate the circumstances which have brought about the development of 'Management Audit'.

Answer to Question No.6(a)

Working Notes

	2009-10	2008-09	2007-08
Sales – Quantity kgs	43,50,890	34,36,921	37,25,405
Sales Value in Rs. Lakhs	5,091	3,938	4,215
Average Sales Realization per kg – Rs.	117	115113	
Raw materials, Stores & Spares consumed (Rs. in Lakhs)	3,728	2,775	2,964
Material cost as % of sales value (%)	73.2	70.5	70.3
Direct Wages cost as % of sales value (%)	3.2	5.4	4.9

Observations:

From the above figures, it is apparent that the company's declining profitability is NOT due to market conditions, as revealed by the following factors:

- The sales price has been marginally increasing year to year.
- The very small increase in material cost is also in step with the increase in sales realization.
- The company has been able to control direct labour cost effectively.
- The level of production has been maintained and has infact improved in the latest year.
- Inventory and book debt levels have been brought down considerably.

On the other hand, the following factors present a disturbing picture and lead to the inference that the financial management is either incompetent or the management has diverted the borrowed working funds to some other activity or has invested in some unproductive assets like vehicles:

	2009-10	2008-09	2007-08 (Rs. in Lakhs)
Long term borrowings	287	180	180
Working Capital Loans	1,639	451	672
Net Block	1,009	541	612
Loans and Advances	2,641	1,286	1,231
Depreciation, Repairs and Maintenance of Vehicles	109	59	54
Interest	277	130	152

The increase in working capital borrowings and the consequent interest thereon were not warranted, especially when the funds blocked in inventory and book debts have come down. The additional interest

burden and additional expenses on vehicles amount to Rs.197 lakhs whereas the increase in loss as compared to the previous year is only Rs.115 lakhs.

Preliminary Conclusion :

- i. Prima facie, it appears that the unit has become sick due to diversion of funds by the management to other activities or for personal expenditure.
- ii. The fixed assets have doubled. But there is no profit accruing by the increased assets.

Answer to Question No.6(b)

Since independence, India has not achieved the desired economic development as planned. Regional and social imbalances have continued over the years, leading to unrest in different parts of the country.

In the industrial field, there is an alarming growth of sickness of industries. Large amount of resources of banks and financial institutions are involved in the rehabilitation of sick industries. In the unorganized sector also sickness is reported. Large amount of loans are being written off by banks and financial institutions, arising out of sickness and inability to recover the loans. The performance of the public sector enterprises is also dismal in spite of state protection, in respect of product monopoly, administered prices, etc. As per the report of BIFR, a major cause for sickness is managerial weakness besides other causes like non-availability of raw materials, shortage of working capital, labour unrest etc.

The main cause of all these economic and social problems can be attributed to managerial ineffectiveness, which in turn, causes other problems. It is therefore, imminent that an appraisal of managerial effectiveness is undertaken to monitor and remedy weaknesses wherever exist. This is the basic function of management audit.

In a developing country like India, Management Audit will help the Government in identifying improper or wasteful use of funds, checking extravagant organization practices and curbing ineffective use of physical resources.

There is an imperative need for Management Audit to help in resource mobilization, conserving scarce resources and to reduce the cost of operations.

In the context of desired economic development not forthcoming and the growing competition and sickness in industry, Management Audit is the trump card.

The above circumstances have necessitated the development of Management Audit.

7. (a) What is Marketing Audit? What are its essential features? 2+4
- (b) What do you understand by 'Corporate Services Audit'? Describe the areas of Corporate Services Audit, the security thereof and the evaluation criteria used in such audit. 2+4

- (c) What is the basis of differences between 'Management Audit' and 'Operational Audit'?

Answer to Question No. 7(a)

Marketing Audit is an independent examination of the entire marketing effort of a company or some specific marketing activities covering objectives, programme implementation and organization for the purposes of determining what is being done, appraising which is being done and recommending what should be done in future.

Essential feature of Marketing Audit

The essential feature of Marketing Audit is that marketing audit is carried out periodically at regular intervals and not only when the company is facing marketing problems and difficulties. Such audit covers both marketing place and control and evaluate the basic framework for marketing action as also the performance within the framework.

Marketing Audit covers the appraisal of the entire system and the process of marketing, after taking into account all the elements of the marketing operations.

Marketing Audit evaluates a total appraisal of the marketing efforts of a company.

The Marketing Audit should appraise the marketing organization by reviewing the formal lines of authority and responsibility, delegation of authority, status of marketing head and his staff, adequacy of the personnel, proper manning of key tasks and assignments thereof.

The Marketing Audit covers the following broad areas :

- Objectives : Marketing Objectives should be clearly established.
- Programme : The auditor should carry out an appraisal for the programme which the company has laid down for achieving the objective.
- Implementation : The auditor will take up the examination of the company's implementation of the marketing programme.
- Organization : A suitable organization assists in a success of a marketing plan.

Answer to Question No.7(b)

The term "Corporate Services Audit" is a generic term, which implies service oriented obligations of a corporate body to different interested 'public' such as consumers, shareholders, community, fellow-businessmen, government, etc. It includes the social responsiveness of a business enterprise. Corporate Services Audit is the audit of the social behavior of the company to assess the extent to which the company had met the expectations of the customers, employees, shareholders, suppliers and the community.

The scope of Corporate Services Audit extends to the critical examination of the different aspects of services and the extent to which the corporate body has rendered satisfactory services. It also includes the evaluation of the degrees of responsiveness and awareness on the part of such enterprise. The perfor-

mance of the management towards customers, employees, shareholders, community, fellow-businessmen and government is studied separately and properly evaluated by management auditor.

The areas of Corporate Services Audit and the scrutiny and evaluation criteria can be categorized as follows :

- Consumers
- Employees
- Shareholders
- Community
- Fellow-businessmen
- State

The concept of Corporate Services Audit is that its appraisal should consider the level of contribution a business entity makes to society and its environment towards raising the quality of life through better product quality and services rather than profit maximization. The Corporate Services Audit thus attempt to distinguish between the end and means of business and provides a new dimension to the concept of audit approach. In Corporate Services Audit, the auditor checks the company's response to different social needs.

Answer to Question No.7(c)

Operational Audit vs Management Audit

Operational Audit concentrates on seeking out aspects of operations in which waste, inefficiency and excessive costs and would be subject to reduction by the introduction of improvement of operating controls. It is the audit of the performance at mainly operating level i.e., supervisory level. It is also termed as micro level management audit.

Operational Audit is an organized search for ways of improving efficiency and effectiveness. The objective is to assist the organization in performing functions more effectively economically with focus on the efficiency and effectiveness of operations. It is also stated to be an early warning system for the detection of potentially destructive problems.

Management Audit extends to the entire management decision making areas and has a broader time-frame to analyze past, present and the future. Hence it becomes a qualitative audit and not audit of only value and quantity. Management Audit brings out errors or policy, decisions and actions with recommendations to avoid them. Management Audit extends beyond Operations Audit.

Management Audit is the total examination of all transactions of an organization and includes checks on the effectiveness of managers and their compliances with company on professional standards. It undertakes examination of the effectiveness of management in controlling the total activities of the organization in the accomplishment of the organization objectives. It does not concentrate on financial matters alone as in case of financial audit. It looks into the efficiency and effectiveness of performance in an organization.

8. Write short notes (any three) :
- (a) State the function of IAASB;
 - (b) Safeguard Duty;
 - (c) ISA 500;
 - (d) Margin of Dumping.

6x3

Answer to Question No.8(a)

International Auditing and Assurance Standards Boards (IAASB) is an independent standards setting body within the International Federation of Accounts (IFAC). The IAASB develops International Standards on Auditing and International Standards on Review Engagements which deal with the audit and review of financial information; and International Standards on Assurance Engagements which deal with assurance engagements other than audit and review of financial information. The IAASB also develops related practice statements. These standards and statements serve as guidelines for high quality of auditing and assurance statements worldwide.

In addition the IAASB develops quality control standards for firms and engagement teams in areas of audit, assurance and related services.

Answer to Question No.8(b)

Safeguard Duty is a step in providing a need based protection to domestic industry for a limited period with ultimate objective of restoring free and fair competition. Central Government is empowered to impose 'safeguard duty' on specified imports. If it is satisfied that goods are being imported in large quantities and are causing serious injury to domestic industry. Such duty is permissible under WTO agreement, only condition is that discrimination cannot be done among imports from different Most Favoured Nations.

Government has to conduct an enquiry and then issue notification under Sec. 8B(1) of Custom Tariff Act. Total period of duty cannot be more than 10 years under section 8B(4) of Customs Tariff Act. Office imposed the duty is valid for 4 years unless revoked earlier. In case of imports from developing countries, such duty can be imposed only if value is more than 3% of total imports of the article in India under Sec 8B(10) of Custom Tariff Act.

Answer to Question No.8(c)

ISA-500-Audit Evidence : This ISA explains what constitutes audit evidence in an audit of Financial Statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. This ISA is applicable to all the evidence obtained during the course of the audit.

Answer to Question No.8(d)

Margin of dumping is the difference between the Normal value and the export price of the goods under reference. It is generally expressed as a percentage of the export price. Both 'normal value' and export price must be compared at the same level, i.e., ex-factory level. Normal value means comparable price at which goods under consideration are sold in ordinary course of trade in the domestic market of the exporting country. 'Export price' is the price at which the goods are allegedly dumping in the importing country.