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CA CS Divya Agarwal

Divya Agarwal is a Chartered Accountant and a Company Secretary and is a Rank Holder at all levels including AIR 3 at the FINAL level. She possesses a rich experience of teaching Law, Strategic Management, Enterprise Information System, Economics, Data Analytics, Operation Management, Strategic Performance Management and Business Valuation at MEPL Classes for 13 years. She is a Gold Medalist in Economics. She has been teaching Foundation, Inter, Final levels for various professional courses like CA, CMA, CS and has mentored more than 100,000 students. Her classes are widely regarded as the best on a PAN INDIA level owing to her innovative approach and practical insights from the industry which makes the subjects very interesting. She has also conducted seminars ALL OVER INDIA at different forums of Institutes – ICAI / ICMAI/ ICSI.

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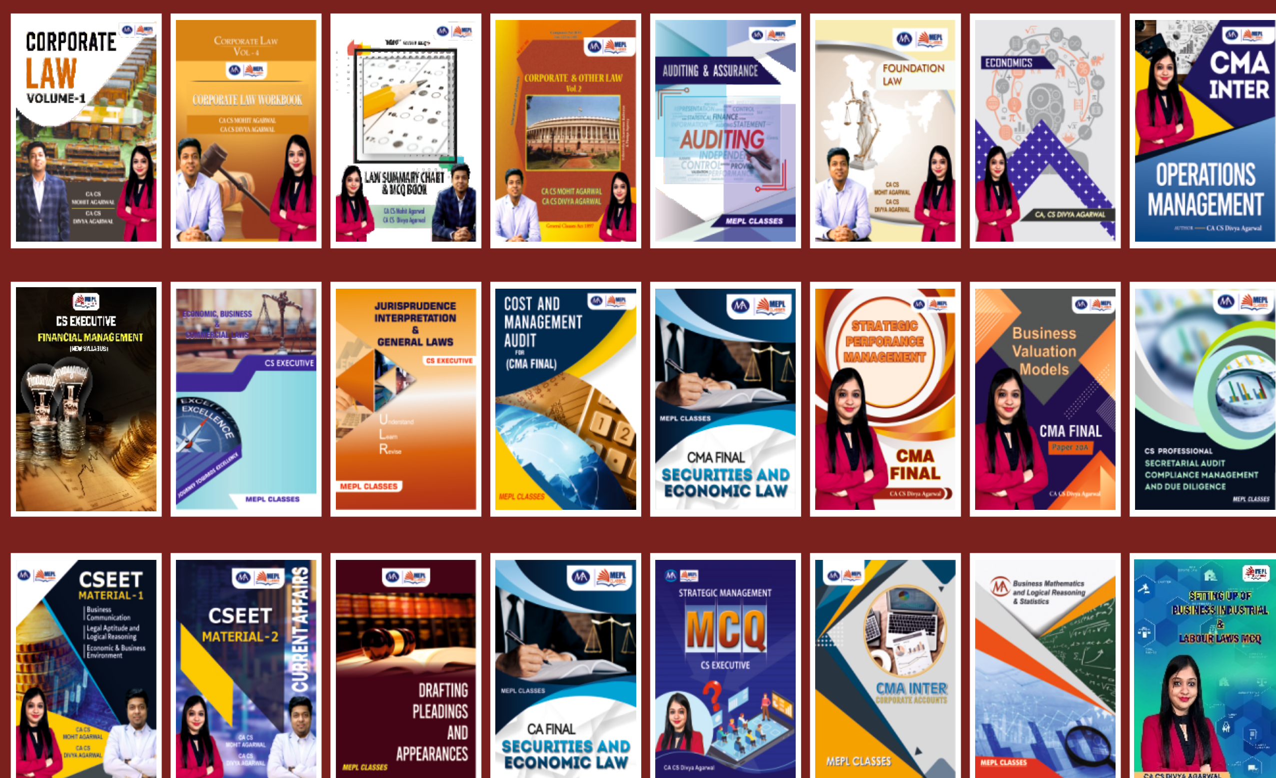

COST AND MANAGEMENT AUDIT

COST AND MANAGEMENT AUDIT

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CHAPTER – 1 Basics of Cost Accounting/Audit

Cost?? → Definition of cost in common parlance?

- Amount paid to acquire something/or spent to buy something.
- The effect, loss or sacrifice necessary to achieve something
- Cost as per Accounting: - "Value of Money" that has been used to produce something or deliver something.

Cost: -

Cost is a measurement, in monetary term, of the amount of resources used/consumed for the purpose of

Production of goods or **Rendering of services**

Cost includes opportunity cost also

Ex: -

Mr. X go to a shop to purchase a PC. The price of PC is ₹ 5000/-

Here ₹ 5000 is the cost to Mr. X

Mr. X is engaged in production of a PC. The PC requires.

Raw Material	500
Manpower	1000
Other O/H	1000
	2500
(+) OC of Machine	2500
	5000
	↓
	Cost which included OC

Meaning of Cost accounting: -

It is the process of

- Identification
- Classification
- Measurement &
- Assignment of various cost to Cost Object.

Meaning of Cost Audit: -

According to CIMA (London) Cost Audit is verification of correctness of cost accounting adherence to cost accounting plan.

Cost Audit is independent Examination of cost statements, costing records, & other related info of an entity with an objective to form an independent opinion.

↓

Cost Audit is done by complying cost accounting standards.

Objective of Cost Audit

- Verification of Cost Accounts/Cost Records
- Ensuring that the cost record are prepared following costing rules
- Detection of error & fraud
- Verification of cost allocated to each cost unit & cost center.
- Facilitates Fixation of Price
- Reconciliation between cost record & Financial Record

Cost Accounting Standards

- These are the standards which lays down costing rules to achieve uniformity & consistency in cost accounting principles & practices.
- Institute of Cost Accountants of India (ICMAI) has constituted Cost Accounting Standards (CAS) →CASB (Cost Accounting Standard Board).

The Objective of CAS

- Uniformity

- Structured approach for cost ascertainment.
- Harmonization & Standardization of costing principle/practices.
- Determination of cost of Product/Services.
- Attestation of cost records by Cost Auditor.

Advantage of Cost Audit

1. Helps the organisation to structure the cost properly which enable in fixing price.
2. Help in reducing the wastage of resources Increasing the performance.
3. Decision Making (Short term & Long term)
4. Reduces manipulation & helps in detection of fraud/error.
5. Optimum utilisation of resources

* Cost Accountant = Cost Auditor Sec 143(1) of Company Act → Cost Auditor

History of Cost Audit: -

<table>
<tr><td rowspan="2">1965</td><td colspan="2">Sec 233B & Sec 209 (1) (d) of Cos Act, 1956</td></tr>
<tr><td>233 B Cost Audit</td><td>209 (1) (d) - Maintenance of Cost Record</td></tr>
<tr><td></td><td colspan="2">Cost Audit of Cost Record as per Cos. Act, 1956
↓</td></tr>
</table>

2011	Manufacturing, Mining & Processing Operation
2014	**Companies (Cost Record & Audit) Rules 2014** ↓ Cos. Act, 2013 Sec 148 → CG may specify audit of items of cost in respect of certain companies

Sec 148→ Gives Power to C G for maintenance of Cost Record & Cost Audit for certain class of Co.

148(1)	Maintenance of Cost Record	For Co. engaged in Production of Goods/services
148(2)	Cost Audit of Cost Records	For Co. exceeding T.O (Product wise & Aggregate)
148(3)	Power to Cost Accountant in Practice	To conduct Cost Audit - Statutory ≠ Cost Auditor
148(4)	Cost Audit is a separate Audit u/s 143	
148(5)	Qualification, Disqualification, Rights, Duties & Obligation of Cost Auditor	* Similar to Statutory Auditor * Cost Auditor Report = BOD

148(6)	Cost Audit Report to CG in 30 days	
148(7)	Additional Information / Explanation from Co.	
148(8)	Default	
	Co/Officer	Cost Auditor
	147(1) of Co. Act 2013	147(2), 147(3), 147(4), 147(5)
	Punishable	Punishable

Note: - Cost Auditing Standards →CAS issued by the ICWAI under ICWAI Act, 1959 Act, 1959

SPACE FOR NOTES

SPACE FOR NOTES

SPACE FOR NOTES

CHAPTER – 2 Companies (Cost Record & Audit) Rules, 2014

↓

[30.6.2014]

1. Meaning: -

Cost Auditing is audit of Cost Records by Cost Accountant in Practice

CMA In Practice can only do Cost Audit

2. Applicability of Maintenance of Cost Record: - (Rule - 3)

If aggregate T.O of company (whether in Regulated Sector i.e., Type A or whether in unregulated (Not regulated) sector i.e., Type B) in immediately preceding F.Y is ≥35 crores (min 35 crores)

Example: Co A

X	Y	
20 cr	15 cr	➡ 35 cr

Cost Record Mandatory u/s 148(1) of Co. Act, 2013

3. Applicability of Cost Audit (Rule - 4): -

- **Regulated Sector (Type - A)**
  - Aggregate T.O in immediately preceding F.Y is ≥ 50 cr & from Individual Product is minimum i.e. ≥ 25 cr
    - ATO (Aggregate T.O) ≥ 50 cr
    - +
    - ITO (Individual Product T.O) ≥ 25 cr.
- **Unregulated Sector (Type - B)**
  - ATO (Aggregate T.O) ≥ 100 cr
  - ITO (Individual Product T.O) ≥ 35 cr
  - [Immediately Preceding F.Y]

Ex: -	**BPCL (Regulated Sector)**			
	Diesel	Petrol	HSD	
	20 cr	20 cr	30 cr	70
Cost Record				
Cost Audit	CR	CR	CR/CA	

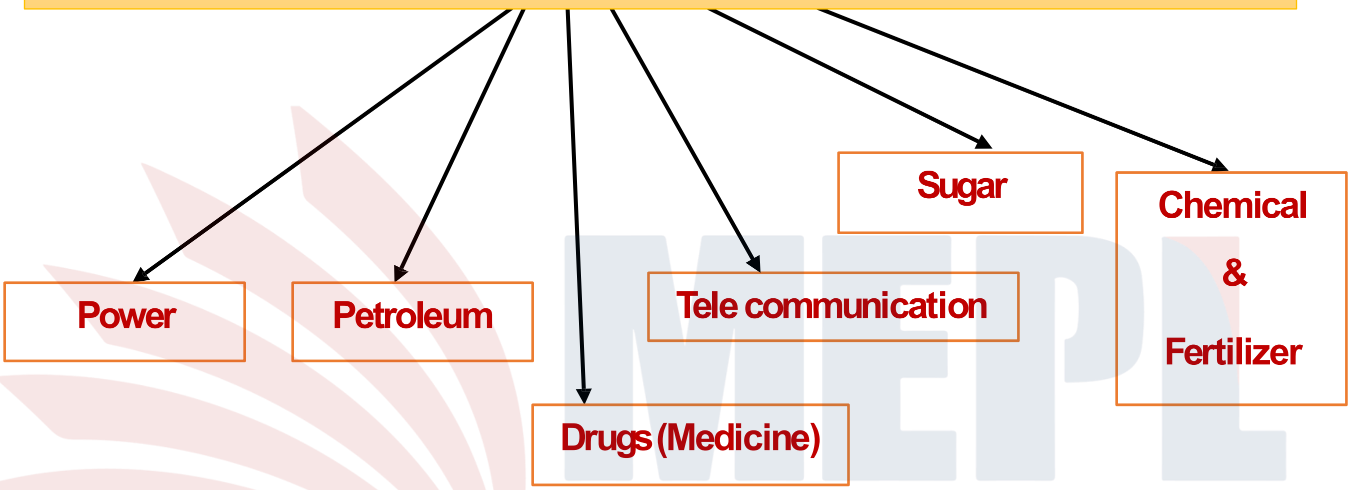
Ex: -	**Co. A (Unregulated Sector)**			
	A	B	C	
	30 cr	20 cr	50 cr	100
Cost Record				
Cost Audit				
	CR	CR	CR/CA	

Ex: -	**Co. A (Unregulated Sector)**			
	A	B	C	
	30 cr	20 cr	40 cr	90
Cost Record				
Cost Audit				
	CR	CR	CR	

Ex: -	**Co. A (Unregulated Sector)**			
	A	B	C	
	34 cr	34 cr	34 cr	

Cost Record				ATO≥ 35 cr
Cost Audit				

4. Type A: - Regulated Sector



5. Type B: - Rest of the Sector/Product/Services as mentioned in the Table

6. Cost Records are Maintained in form CRA-1

7. Appointment of Cost Auditor (Sec 177 of Company Act, 2013)

If Audit Committee exist

↓

Audit Committee will recommend the name of Cost Auditor

↓

BOD shall Appoint

If Audit Committee does not exist

↓

BOD shall Appoint

Notes – Sec 177 → Audit Committee

- ✓ Every Public company (listed) shall appoint/Unlisted Public company an Audit Committee.
- ✓ Min 3 directors shall consist of Audit Committee.

↓

Majority Independent Directors

Notes – Audit Committee duties is to recommend the Audit

- **On Every Listed Public Company**
- **Unlisted Public Co.**
  - ✓ PUSC min 10 crores
  - ✓ Loan, Debenture, Borrowings e.g., min 50 crores
  - ✓ T.O min 100 crores

8. Remuneration of Cost Auditor: -

If Audit Committee exist

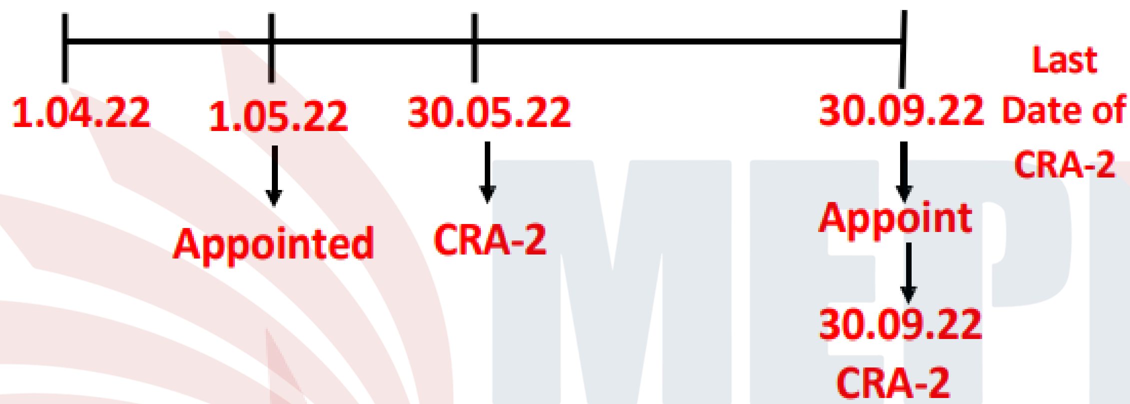
Audit Committee will recommend
↓
BOD shall fix
↓
SH shall approve (GM)

If Audit Committee does not exist

BOD shall fix
↓
SH shall approve (GM)

9. Time Limit of Appointment: -

Cost Auditor shall be appointed within 180 days from the commencement of F.Y & Company shall inform about the appointment in form CRA-2 to CG (ROC) within 30 days of appointment or 180 days of commencement of F.Y whichever is earlier.



10. Casual Vacancy: -

All the Casual Vacancy shall be filled up by the BOD within 30 days of such casual vacancy. Company shall inform the CG(ROC) within 30 days of filling such casual vacancy by submitting form CRA-2.

11. Removal of Cost Auditor: -

BOD may remove the Cost Auditor without prior approval of CG.

12. Qualification, Power & Duties of Cost Auditor: -

Same as Company Auditor (with necessary changes) - "Mutatis Mutandis"

13. Can Co. auditor be appointed as a Cost Auditor of the company?

→No.

14. Can internal auditor be appointed as a Cost Auditor of the company?

→No.

15. Time limit for Completion of Cost Audit: -

Cost Audit shall be completed within 180 days from the end of F.Y & Cost Auditor shall submit the Cost Audit Report in Form CRA 3 to the company

& within 30 days co. shall along with the explanation to any adverse remark (if any) submit the report to ROC in form CRA-4.

Note – The company shall submit CRA-4 in 30 days from the date of receipt of Cost Audit Report.

Note – The CG may ask for additional information & explanation, if necessary, from the company.

16. Exemption from Cost Audit: -

- Unit in SEZ
- Co. where revenue from export in FOREX > 75% of Total Revenue
- Unit for Captive Consumption

Rule 4 will not apply but Rule 3 shall apply i.e., Maintenance of Cost Record

17. Examples on Rule 3 & Rule 4 → For Exam Purpose

Example – 1: -

ABC Ltd is a company engaged in manufacture of products listed in Table A, Table B and some unlisted products also.

			CR	CA
Regulated	Product X (T-A)	30 cr		≥ 25 cr
Unregulated	Product Y (T-B)	35 cr		≥ 35 cr
	Product Z (unlisted)	40 cr		
		105 cr		

Solution: -

1. As per Rule 3 of the Companies (Cost Record & Audit) Rules 2014 the company is required to maintain cost records of the products or services listed in Table A or Table B as the case may be if the aggregate T.O of the company exceeds 35 cr or min 35 cr.

2. In the given case the aggregate T.O of the company is ₹ 105 cr which is >35 cr. Hence the company is required to maintain the cost record of Product X & Product Y only. Since Product Z is neither a product of Regulated (Table A) or Unregulated (Table B). So, no cost record for Product Z.

3. As per Rule 4(1) for the products in Table A. If the aggregate T.O of the company is min 50 cr & the aggregate T.O of individual product is min 25 cr. Then cost audit is mandatory for such product/services.

4. As per Rule 4(2) →The product/services of Table B (i.e., unregulated sector, there is a requirement of Cost Audit for Table B Product if the Aggregate T.O of the co. is min 100 cr & Individual Product T.O is min 35 cr.

5. In the given case since the aggregate T.O of the company is greater than 100 cr or 50 cr (as per Rule 4(2) & Rule 4(1) of the Cost Record & Audit Rules, 2014 & the aggregate T.O of Individual Product of Table A is 30 cr ≥ 25 cr & Table B is 35 cr ≥ 35 cr. Then the co. is required to conduct Cost Audit for Product X & Product Y. But there is no requirement for Cost Audit of Product Z.

<table>
<tr><td colspan="2">Example – 2: -</td><td colspan="3">ABC Ltd</td></tr>
<tr><td colspan="2"></td><td>Power</td><td>Black Carbon</td><td>Other By Product Scrap</td></tr>
<tr><td colspan="2"></td><td>20 cr</td><td>40 cr</td><td>10 cr</td></tr>
<tr><td colspan="2">CR: - ≥ 35 cr</td><td rowspan="5"></td><td rowspan="5"></td><td rowspan="5"></td></tr>
<tr><td colspan="2">CA: -</td></tr>
<tr><td>Table A</td><td>Table B</td></tr>
<tr><td>TO ≥ 50 cr</td><td>≥ 100 cr</td></tr>
<tr><td>ITO ≥ 25 cr</td><td>≥ 35 cr</td></tr>
</table>

Example – 3: -		ABC Ltd		
		Power/ Electricity	Table B	By Product
		30 cr	40 cr	100 cr
Rule 3	CR: - ATO = 170 cr			
Rule	CA: -	ATO= 170 cr ITO = 30 cr	ATO= 170 cr ITO = 40 cr	
		Rule 4(1)	Rule 4(2)	

Example – 4: - Incorrect but Correct as per Institute Mat

		ABC Ltd		
		Table A	Table B	Table C
	T.O.	19 cr	14 cr	76cr
Rule 3	CR: - ≥ 35 cr ATO = 109 cr			
	CA: -	ATO= 109 cr ITO = Table A + Table B (19+14) = 33 cr	ATO= 109 cr ITO = Table A + Table B (19+14) = 33 cr	

		Since ≥ 25 cr	Since ≥ 35 cr	

Example – 5: -	ABC Ltd		
	Table A	Table B	Unlisted
	22 cr	21 cr	58 cr
CR: -	≥ 35 cr	≥ 35 cr	≥ 35 cr
CA: - 1 ST	≥ 50 cr	≥ 100 cr	≥ 100 cr
2nd	Table A + Table B (22+21) = 43 cr	Table A + Table B (22+21) = 43 cr	
	Since ≥ 25 cr	Since ≥ 35 cr	
	As per Institute Mat		

(18) The Rule 3 of Companies (Cost Record & Audit) Rules, 2014 does not apply to the following

	Micro Enterprises	Small Enterprises	Registered under MSMED, Act 2006
Investment in Plant & Machinery	≤ 1 cr	≤ 10 cr	
T.O.	≤ 5 cr	≤ 50 cr	

(19) CRA-1	Maintenance of Cost Record
CRA-2	Appointment of Cost Auditor
CRA-3	Cost Audit Report - To BOD
CRA-4	Cost Audit Report - CG

(20) Items included in CRA-1

All types of Cost
1. Material
2. Labour
3. Overhead (OH)
4. Fixed Asset & Depreciation
5. Finance Cost
6. Capacity Determination
7. Captive Consumption
8. Work-in-progress/Finished Goods
9. By Product/Scrap
10. Cost Statements
11. Reconciliation of Financial Accounts & Cost Records

(21) CRA-2: - Details of Company & Auditor

• CIN
• Details of Company
• Details of Cost Audit
• Board Resolution
• Details of Product of which Cost Audit is conducted
• Details of Previous Cost Audit
• Year for which Cost Audit is conducted.

(22) CRA-3: - Detailed report on Material / Labour / Expense incurred by the company for the manufacture of Product or rendering of services

IT HAS BEEN DIVIDED INTO 4 PARTS:

Part A
- General Information
- Information about Cost Auditor
- Cost Accounting Policy
- Product/Services

Part B
- Manufacturing Sector

Part C
- Service Sector

Part B and Part C:
- Quantitative Information
- Abridged Cost Statement
- Details of Materials Consumed
- Details of Utilities Consumed
- Details of Industry Specific Operating Expenses

Part D
- Product & Service Profitability Statement
- Profit Reconciliation
- Value Addition
- Financial Position & Ratio Analysis
- Related Party Transactions
- Reconciliation of Indirect Taxes

(23) CRA-4: - It is an extension of CRA-2

It contains

(1)General Information –
- Such as CIN Number
- Cost Auditor detail
- Product/services detail
  a) Cost Record
  b) Cost Record not maintained

(2)Qualification / Reservation / Suggestion by Cost Auditor with explanation.

(3)XBRL (world-wide standard format for submitting Financial Information) format all Cost Audit Report to be submitted

(24) Company (Cost Record & Audit Rule) 2014 came into force on 30.6.2014

PRACTICAL FROM CHAPTER 2

- Para 3 – Part D of CRA-3

Value Addition & Distribution of Earning

Particulars		C.Y	P.Y
# **Value Addition**			

[Revenue from Operation (-) Total cost of Bought out Inputs]			
A. Revenue from Operation	xxx		
Less: Taxes & Duties	xxx		
B. Net Revenue from Operation		xxx	
Add: Export Incentive		xx	
Add: Increase in Stock		x	
Less: Decrease in Stock		xx	
		x	
		xx	
		x	
C. Revenue from Operation after adjustment of stock	✓	xxx	
D. Less: Cost of Bought out Inputs	✓		
(i) Raw Materials consumed	✓		
(ii) Process Material	✓		
(iii) Stores & Spares	✓		
(iv) Utilities (Power/Fuel)			
(v) Any other [Administrative, Manufacturing & selling OH]	✓ ✓		
(vi) Audit Fees			
(vii) Interest on Working Capital (Excluding long term loan)			
Total cost of Bought out Input		xxx	
E. Value Addition (C – D)		xxx	
Add: Income from other source			

Add: Extraordinary Income Add: Other Comprehensive Income			
F. Earnings Available for Distribution			
# Distribution of Earnings to Stakeholders (i) Employees (Salaries, Wages & other Employee Cost) (ii) Shareholders as Dividend (Exclusive of Taxes) (iii) Company (as retained earning) (iv) Government as Taxes [DDT, IT, GST etc] (v) Extraordinary Expenses or Exceptional Expenses (vi) Others, if any (Providers of Capital) * Interest long term loan * Debentures Interest			
G. Total Distribution of Earning		xxx	
[F = G Then your answer is correct]			

 # Illustration No. – 2: -

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

Year ended 31st March	2022	2021

	(Amount in ₹ lakh)	
Net Sales	4,800	3,840
Other Income	300	200
Increase in Value of Stock of Finished Goods	20	10
Raw materials Consumed	1,760	1,440
Direct wages, Salaries, Bonus, Gratuity etc.	440	352
Power & Fuel	240	192
Stores and Spares	160	140
Cess and local Taxes	120	100
Other manufacturing Overheads	430	370
Administrative Overheads:		
Audit fees	36	30
Salaries & Commission to Directors	48	40
Other Overheads	260	220
Selling and Distribution Overheads:		
Salaries & Wages	36	30
Packing and forwarding	20	16
Other Overheads	250	200

Total Depreciation	**120**	**120**
Interest Charges:		
On Working Capital Loans from Bank	**60**	**25**
On Fixed Loans from IDBI	**90**	**70**
On Debentures	**30**	**30**
Provision for Taxes	**316**	**200**
Proposed Dividends	**420**	**230**

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

- Value Addition
- Earnings available for Distribution
- Distribution of Earnings to the different claimants.

 # Illustration No. – 1: -

The following figures are extracted from the statement prepared by the Cost Accountant and the Trial Balance of ABC Ltd., which is a single product company:

(₹ In lakhs)

	31.03.2022	31.03.2021	31.03.2020
Net Sales	1,745	1,705	1,610
Raw Materials consumed	1,140	1,060	975
Direct Wages	35	32	27
Power and Fuel	30	27	24
Stores and Spares	6	5	4
Depreciation charged to production cost centres	16	15	13
Factory overheads:			
Salaries and wages	5	4	3
Depreciation	2	2	2
Rates and Taxes	1	1	1
Other overheads	6	5	4
Administrative overheads:			
Salaries and Wages	10	9	8
Rates and Taxes	2	2	2
Other overheads	162	154	148
Selling and distribution overheads:			
Salaries and Wages	7	6	5
Packing and forwarding	6	6	5
Depreciation	1	1	1
Other overheads	124	118	108

Interest	85	74	68
Bonus and Gratuity	12	10	9
Gross Current Assets	840	724	640
Current Liabilities and Provisions	324	305	246

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

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

Reconciliation of Profit of Financial Accounts & Cost Accounts

	Profit as per Financial Accounts		xxx
(I)	Add: Expense not allowed as per CAS as a cost item		
	✓ Expense on CSR	xxx	
	✓ Post Retirement Benefit (VRS) / Medical grant	xxx	
	✓ Loss on Sale of Fixed Asset	xxx	
	✓ Trading Loss (Add Expenses also)	xxx	
	✓ Donation paid	xxx	
	✓ Loss investment	xxx	
	✓ Renovation Expenses whose benefit will accrue in future	xxx	

	✓ Others, if any	xxx	
			xxx
(II)	Less: Income not considered as per Cost a/c standards		
	✓ Profit on Sale of Fixed Asset	xxx	
	✓ Subsidy	xxx	
	✓ Recovery of Litigation (Prior Period)	xxx	
	✓ Favourable Exchange rate variation		
	✓ Tax Refund	xxx	
	✓ Income from Investment	xxx	
	✓ Non-operating Income	xxx	
	✓ Trading Profit (Less Exp)	xxx	
	✓ Insurance Recovery (claim recovery)	xxx	
	✓ Interest Income	xxx	
	✓ Others	xxx	
		xxx	
			(xxx)
(III)	Add: Valuation of Stocks		
	✓ (+) Closing Stock undervalued in FA	xxx	
	✓ (-) Closing Stock overvalued in FA	(xxx)	
	✓ (+) Opening Stock or WIP overvalued in FA	xxx	
	✓ (-) Opening Stock or WIP undervalued in FA	(xxx)	
	✓ (-) Closing Stock undervalued in Cost Record	(xxx)	
	✓ (+) Closing Stock overvalued in Cost Record	xxx	
	✓ (-) Opening Stock or WIP overvalued in FA	(xxx)	

	✓ (+) Opening Stock or WIP overvalued in FA		xxx	xxx
(IV)	Add/Less: Captive Consumption or self-consumption			
	Less:	Value of Captive Consumption if the value is higher in Financial A/c [Value as per FA - Value as per CA]		(xxx)
	Add:	Value of Captive Consumption is Lower in FA [CA – FA]		xxx
	Less:	Cost of Captive Consumption shown as per cost instead of Tariff value [FA – CA]		(xxx)
	Add:	Cost of Captive Consumption shown higher in FA [CA – FA]		xxx
	Profit as per Cost			xxx

∗ Illustration No. –4: -

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

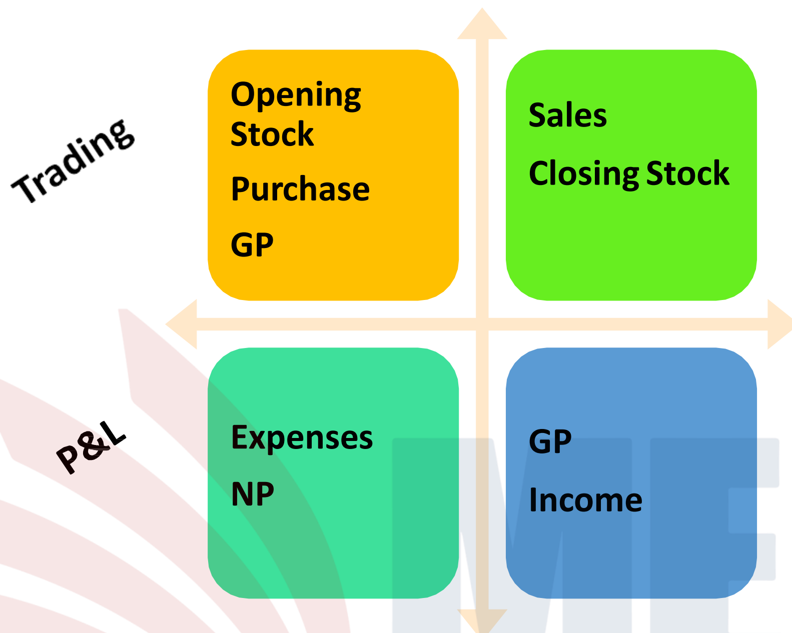
	Financial Accounts ₹ '000	Cost Accounts ₹ '000

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

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

Shortcut method for Reconciliation: -

Trading & P/L A/c



For shortcut we assume that whatever expenses, Income shown in question has not been considered in making Trading & P/L.

Illustration No. – 5: -

Auto Parts Manufacturing Company Ltd. showed a profit for the year 2021-22 as ₹ 35,46,700. During the course of Cost Audit, the followings transactions were noticed:

(i) an old machine with net value of ₹ 6,54,000 was sold off for ₹ 9,30,000,

(ii) dividend income was received amounting to ₹ 84,500 from investments,

(iii) a sum of ₹ 58,000 was spent towards CSR commitment,

(iv) the company was engaged in trading activity where purchase of goods was ₹ 13,50,000 and sales was ₹ 13,42,300, after incurring ₹ 40,800 as expenditure,

(v) some renovation work was carried out at a cost of ₹ 7,75,000 and its useful life was only for five years, and

(vi) the closing inventory of raw material was undervalued ₹ 29,600 and that of finished goods was overvalued ₹ 65,400 in the financial records. Work out the Profit as per the Cost Accounts.

Illustration No. – 6: -

The profit as per financial accounts of M/s Kalingpong Himalaya Private Company for the year 2021-22 was ₹ 1,54,28,642. The profit as per Cost Accounting Records for the same period was less. You are required to prepare a reconciliation statement and arrive at the profit as per Cost Records. The following details are collected from the financial schedules and cost accounting records:

		Financial Accounts	Cost Accounts
Valuation of Stock			
Opening:	WIP	25,62,315	22,65,710
	Finished Goods	2,65,47,520	2,92,18,950
Closing:	WIP	42,75,640	37,36,346
	Finished Goods	3,72,59,430	4,35,25,149
Interest income from inter-corporate deposits		6,15,340	—
Donations given		4,85,560	—
Loss on Sale of Fixed Assets		1,22,546	—
Value of cement taken for own consumption		3,82,960	3,65,426

Cost of Power drawn from own Wind Mill		
— At EB tariff	—	49,56,325
— At cost	36,20,37	—
Non-operating income	0	—
Voluntary retirement compensation	45,36,770	—
Insurance claim relating to previous year	16,76,540	
received during the year		—
	14,35,620	

Illustration No. – 7: -

The Cost Accountant of TRINCUS TEXTILES MILLS LTD. has arrived at a Profit of ₹ 20,10,500 based on Cost Accounting Records for the year ended March 31, 2022. Profit as per Financial Accounts is ₹ 22,14,100.

As a Cost Auditor, you find the following differences between the Financial Accounts and Cost Accounts:

		₹
(1)	Profit on Sale of Fixed Assets	2,05,000
(2)	Loss on Sale of Investments	33,600
(3)	Voluntary Retirement Compensation included in Salary & Wages in F/A	50,25,000
(4)	Donation Paid	75,000
(5)	Insurance Claim relating to previous year received during the year	5,08,700
(6)	Profit from Retail trading activity	32,02,430

(7)	Interest Income from Inter-Corporate Deposits	6,15,000
(8)	Decrease in value of Closing WIP and Finished goods inventory	
	as per Financial Accounts	3,82,06,430
	as per Cost Accounts	3,90,12,500

You are required to prepare a Reconciliation Statement between the two Accounts for the year ended March 31, 2022.

SPACE FOR NOTES

SPACE FOR NOTES

SPACE FOR NOTES

CHAPTER – 3 Cost Auditor

"Cost Auditor" means a Cost Accountant in Practice (as defined under cost and works Accountant act, 1959) appointed by the board to do the audit of cost records of the company as per sec 148 of the Co. Act, 2013.

Sec 148 (5)

↓

Rights, Duties, Obligation, Qualification, Disqualification of the Auditor

↓

Cost Auditor
[Sec 139 to Sec 148] of Co. Act, 2013

Sec – 141 (Co. Act, 2013) → Qualification & Disqualification of the Auditor

Qualification of Auditor

Sec 141(1)

- A person can be appointed as an auditor of the company only if he is a qualified Chartered Accountant
- Provided a firm can also be appointed as an auditor of the company only if the Majority of the Partners of the firm are qualified CA and Practising in India

Sec 141(2)

- If a firm including LLP is appointed as an auditor of the company, then only the partners who are CA are allowed to act & sign on behalf of the firm

Sec 141(3) → Disqualification of the Auditor

(a) Body Corporates except LLP

→ **(Lawmakers wanted that the auditor should be personally held liable for any fraud but this was not possible in case of a Body Corporate)**

(b) Officer as employee of

→ **(independence)**

(c) Person who is a partner or in employment of officer or employee of the company

→ **(independence)**

Example
Rocky Bhai & Anant Ambani [Jhumritelaiya & Company)

Sec 141(3)

(d) Person is disqualified if he or his relative or his partner

(i) holds shares in the company or its holding or its subsidiary or its associate or its Fellow subsidiary (subsidiary of holding) Example: CA CS Dipak Agarwal, CA Divya Agarwal & Reliance Retail Audit

↓

Provided that relative may hold shares in the company of FV not exceeding ₹ 1000 or any other amount as may be prescribed (currently ₹ 1 Lakh)

↓

If relative is holding FV > 1 Lakh than corrective action must be taken within 60 days

(ii) indebted for an amount exceeding ₹ 5 Lakh in Co/HC/SC/AC /FS

(iii) given guarantee as security to Co/H/S/A/FS of any third party for an amount exceeding 1 Lakh [Example: Chunu Munu]

(e) a person or firm is disqualified if it has direct/indirect business relationship with Co/H/S/A/FS

- CA firm professionally CA work
- Customer purchasing some product

does not amount to business relationship

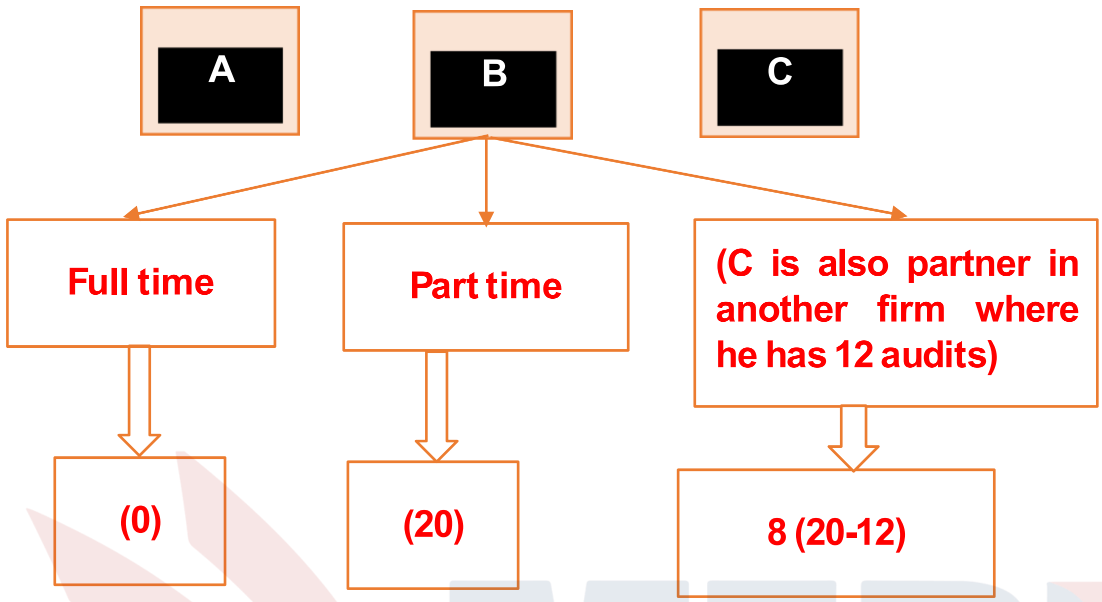
(f) a person is disqualified if his relative is a director or in employment as a KMP of the company.

(g) a person is disqualified to conduct more then 20 audits in a year

Discuss Ceiling Limit

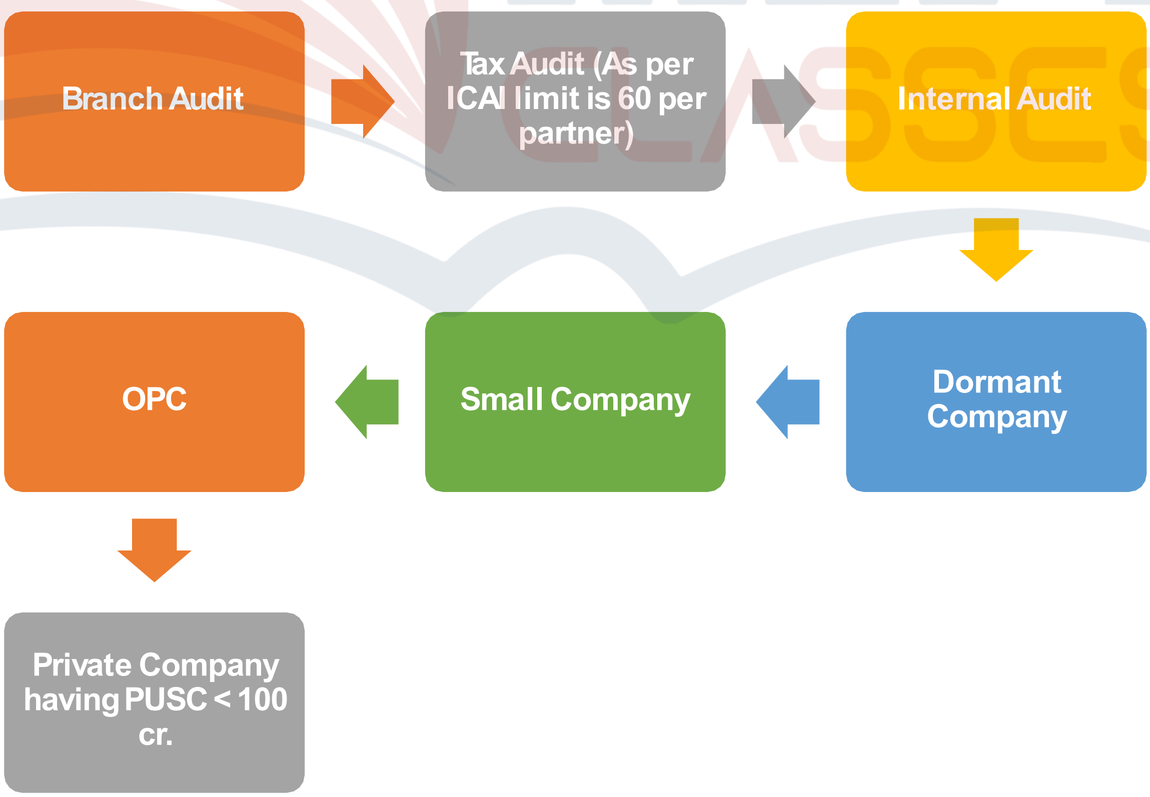
Ceiling Limit for no. of audit i.e., 20/partner who is not in Full time employment elsewhere

E.g., ABC are partners of CA firm



=28 Audits/year

Following Audits are not counted in the Ceiling Limit.



(h) A person is disqualified for 10 years from the date of conviction of an offence involving fraud & imprisonment

(i) A person is disqualified if he has rendered any services u/s 144 to the Co/H/S/A/FS

↓

1) Investment Banking Services
2) Internal Audit
3) Investment Advisory
4) Actuarial Services
5) Management Consultancy
6) Business Consultancy
7) Book Keeping Services

↓

Reason → Since, Lawmaker wanted the auditor to be unfamiliar with the management/ employee of the company & the financials

↓

to give true & fair view

Cost & Management Audit

Paper – 17

Chapter – 3: - Sec – 143 of Co. Act, 2013

Power & Duties of the Auditor

Auditor has the right to

access the books of A/cs whether kept at the registered office or other office.

The term books of A/c has a broad meaning → includes journal, ledger, day books, financial statement, costing records, statistical & statutory books, voucher, bills etc.

Right to access the books of A/cs of subsidiary & Associates also.

seek information or explanation or clarification from company's officers or employee

Duty of the auditor to inquire into the fall using matters
a) If company has given loans & advances without Adequate security or terms of the Loan is prejudicial to company's interest
b) Book entries if any passed by company which is prejudicial to the interest of the company.

c) Company sold its investment below cost (Except Banking Company & Investment Company)	
d) Loan given by the company shown as Deposits	
e) Director's Expense (personal) are shown as revenue expense (or charged to company's revenue A/c)	
f) If shares issued for cash, whether such cash actually received or not & proper details relating to issue of shares maintained or not	

Cost Auditor	There are other rights also as per Company Act u/s 146 & u/s 145) ICAI guidelines → Right to Lien

Sec 143(2):	It is the duty of the auditor to comment that according to the information & explanation received by the auditor and to the best of his knowledge & belief whether company's financial statement is giving/showing true & fair view or not.

Sec 143(3): -

(a) whether all the information & explanation which according to his knowledge were required for the purpose of the audit has been sought & obtained by him (auditor) or not. If not details thereof.

(b) whether Books of A/c (BOA) as by law (required) have been properly maintained by company or not.

(c)	whether branch audit report has been received for those branches whose audit was conducted u/s 143(8) by person other than company auditor.
(d)	whether P&L/BS are in agreement with the books or not.
(e)	whether FS comply with Accounting Standards or not.
(f)	auditor observation or comment on the FS which may have any adverse impact on the functioning of company.
(g)	whether any Director is disqualified u/s 164(2)

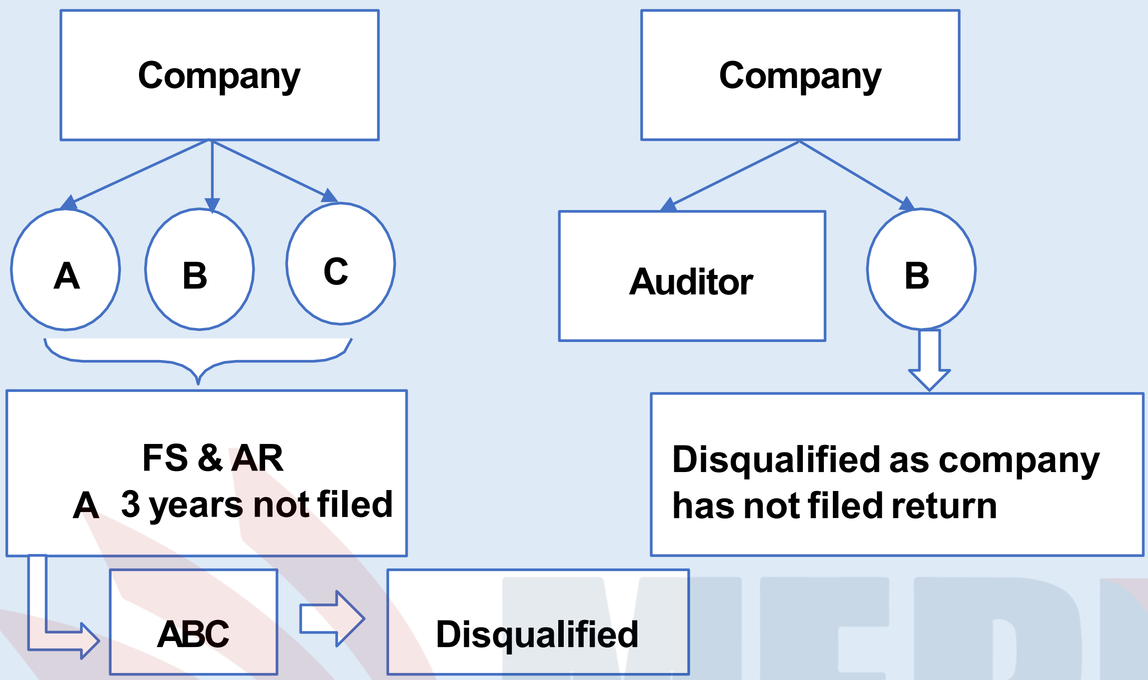
All director of a company shall be disqualified for next 5 consecutive years if such company default in

Filing of Financial Statement or annual return for consecutive 3 years

or

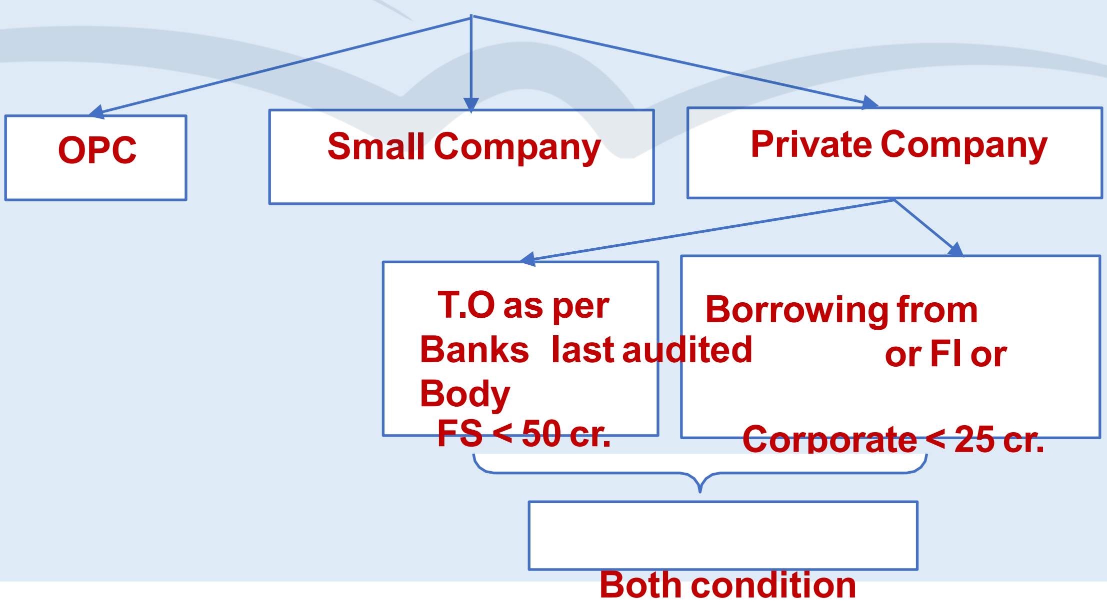
Failed to repay

- ✓ the deposit or interest thereof
- ✓ Debenture or interest thereof
- ✓ Pay dividend (declare) & such default continues for 1 year or more

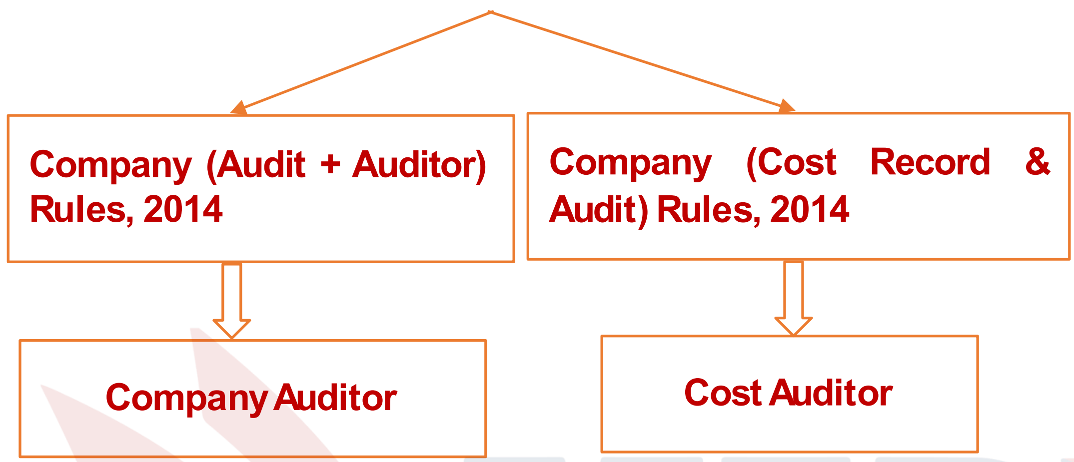


(h) auditor's comment or observation or any adverse remark regarding maintenance of A/c by company.

(i) whether proper internal financial control related to FS & whether the same is operating effectively or not



(j) any other matter as may be prescribed



Sec 143(4):	If an auditor issues an audit report other than clear report, he must give reasons for such report.

Supplementary Audit (Applicable to Government company's)

143(5)

Auditor of Government Company shall submit its audit report to the C & AG which shall contain the following

- Directions given by the C & AG if any at the start of the audit
- Actions taken by the auditor on the basis of such direction
- Impact of the audit on the FS

143(6)

within 60 days of receiving the audit report the C & AG may conduct a supplementary audit to get more information about any item on the FS by appointing one or more person to comment on the audit report

Provided that such supplementary report or comment of C & AG shall also be circulated u/s 136 to all the members & also laid down in AGM along with the Audit Report.

143(7)

C & AG has the power to conduct a Test Audit as per C & AG rules

Branch Audit 143(8)

Indian Branch → Can be audited by the Company Auditor or any person qualified as an auditor under Company Act, 2013

Foreign Branch → Can be audited by Company Auditor or a person/accountant qualified as per foreign law

143(9) ➔	Every auditor shall conduct the audit as per the standards on Auditing.
143(10) ➔	CG shall prescribe the standards on Auditing in consultation/recommendation with ICAI & after consultation with NFRA (National Financial Reporting Authority)
143(11) ➔	CG may prescribe Company Auditor Report Order
143(12) ➔	Auditor's Duty to Report Fraud done by the Company's Officer or Employee → against the company.

Read with Rule 13

- **Fraud Amount < 1 cr. (individually taken & not aggregate)**
  - Auditor shall within 2 days of the knowledge of fraud shall inform Audit Committee (AC) or if no AC to BOD
    - Nature of Fraud
    - Amount Involved
    - Parties Involved
  - BOD shall mention in its Board Report u/s 134(3)
    - Nature of Fraud
    - Amount
    - Parties Involved of remedial action not taken
    - Remedial action taken

- **Fraud Amount > 1 cr.**
  - Auditor shall inform within 2 days of the knowledge of the fraud inform AC/BOD (as the case)
    - Nature
    - Amount Involved
    - Party Involved
  - & give reply within 45 days (time)
    - AC/BOD replies *
    - AC/BOD not reply *

- If AC/BOD replies

Auditor shall within 15 days from the receipt of reply inform CG (MCA) in Form ADT – 4

- Nature of Fraud
- Party involved
- Amount of Fraud
- Reply received from BOD/AC
- Auditor's observation of such reply

- If AC/BOD don't reply

Auditor shall within 15 days from the day of expiry of 45 days → inform CG (MCA) in Form ADT – 4

- Nature of Fraud
- Amount involved
- Party involved
- Reply not received

Notes:	1) Form ADT – 4 shall be addressed to the Secretary, MCA. 2) It shall be sent via speed post followed by EMAIL or registered post with acknowledgement (Registered AD) 3) It shall be sent by auditor's letterhead containing auditor's details (email, phone number, address etc.)

143 (13) →	Auditor should not be held guilty if he has exercised good of faith but still unable to discover the fraud.

143 (14) →	Fraud reporting shall be done in the same manner as prescribed in sec 143 (12) read with Rule 13 **Cost Auditor u/s u/s 148** — **Secretarial Auditor 204**

143 (15) →	Fine for contravention for sec 143(12)

	Listed Company	Unlisted Company
	Auditor – 5 Lakh	Auditor – 1 Lakh

Sec – 447 – Punishment of Fraud

Fraud Amount ≥ 1% of the T.O. or 10 Lakh whichever is lower

↓

Minimum Fine: Fraud Amount (20 Lakh)
Example: 800 Lakh (8 cr.)
1 % = 8 Lakh or 10 Lakh
Fraud Amount: 20 Lakh

↓

Minimum Fine: 3 times of Fraud amount
AND
Minimum Imprisonment: 6 months
Maximum Imprisonment: 10 years

If PI is involved → Minimum Imprisonment 3 Years

Fraud Amount < 1% of the T.O. or 10 Lakh whichever is lower

↓

Public Interest is not involved

↓

Fine up to 50 Lakh
or
Imprisonment upto 5 years

[The court will decide the punishment if he is found guilty on the basis of the fraud
The court will take decision based on the Act]

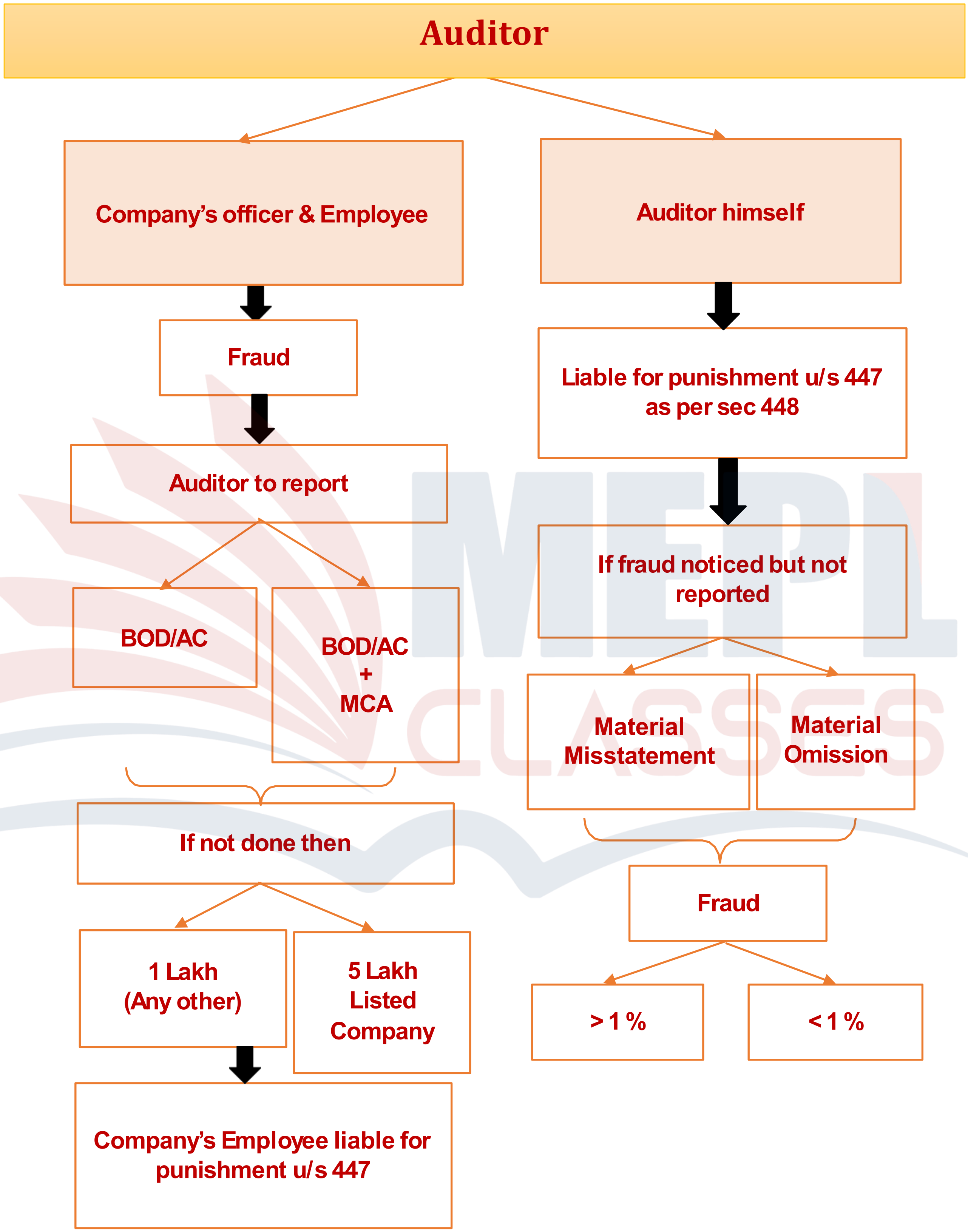
Punishment for False Statement u/s 448

If any person

- makes a false statement of a material fact knowing that it is false
- ommit any material fact knowing that it is material

then such person shall be liable for fraud u/s 447.

Example:	If a cost auditor of the company appointed u/s 448 intentionally gives a false report then as per sec 448 he is liable for punishment u/s 447.


Auditor
Company's officer & Employee
Fraud
Auditor to report
BOD/AC
BOD/AC + MCA
If not done then
1 Lakh (Any other)
5 Lakh Listed Company
Company's Employee liable for punishment u/s 447
Auditor himself
Liable for punishment u/s 447 as per sec 448
If fraud noticed but not reported
Material Misstatement
Material Omission
Fraud
> 1 %
< 1 %

Section applying to Cost Auditor
1) Qualification & Disqualification: - Sec 141(1), Sec 141(2), Sec 141(3)
2) Power & Duties → Sec 143
3) 447/448

Appointment, Rotation, Resignation

↓

Rule-6

Rule 6 of (Company Cost Record & Audit Rules 2014)

(1) **Rule 6(1)**

180 days → Appointment → Already written

Before such appointment written consent must be taken from the Cost Audit + Certificate

↓

Sec- 141 → The auditor is qualified to be appointed as a Cost Auditor

↓

He fulfils the eligibility criteria of the Cost & Works Accountant Act, 1959

↓

The company is satisfying the T.O. or the limits specified in the Act +Auditor also within the limits satisfied →20 audit Limit

<table>
<tr><td></td><td colspan="2">List of Proceedings with respect to Professional Misconduct →
Partner/Firm/Individual → True & Fair (He should give a certificate that these proceedings are correct or not)</td></tr>
<tr><td rowspan="6">(3)</td><td colspan="2">Audit shall continue the appointment

180 days from Cost closure of FY
or
Till he submits Audit Report</td></tr>
<tr><td colspan="2">180 days → Oct'23 → Vacate
Report → Nov → Appointment →
His appointment will continue till November</td></tr>
<tr><td colspan="2">Report → July → July term start → His appointment will last till July</td></tr>
<tr><td>Casual Vacancy (3A)</td><td>Removal (3)</td></tr>
<tr><td>30 days</td><td>Appointment of New Auditor</td></tr>
<tr><td>CRA – 2</td><td>MCA → CRA – 2</td></tr>
<tr><td>(3B)</td><td colspan="2">BOD approval of any annexure to Cost Audit Report</td></tr>
<tr><td>(4)</td><td colspan="2">CRA – 3</td></tr>
<tr><td>(5)</td><td colspan="2">180 days from end of FY → Cost Audit Report to BOD</td></tr>
<tr><td>(6)</td><td colspan="2">Cost Audit Report Company to MCA 30 days</td></tr>
</table>

(7)	143(12) → Apply

Resignation of Auditor (Cost)	The cost auditor shall file within 30 days (From the date of resignation), a statement with the company's Registrar → 50000 Penalty up to → 500000 Penalty
Rotation of the Cost Auditor	The Act is silent about the Rotation of Cost Auditor

Strategic Positions by a Cost Accountant	
a) Key Managerial Person	As per sec 203 of the Company Act Sec 203 → Managing Director Manager CEO ⇩ Whole time director → CS → CFO
b) Independent Director	Sec 149(4) → Total Number of Director → 1/3 → Independent Director

<table>
<tr><td rowspan="2"></td><td>Rule 5:</td><td>Company (Appointment & Qualification of Director) Rules, 2014
↓
Rule 5
↓
Skills are there in the field such as commerce, accounts, tax etc
↓
Independent Director</td></tr>
</table>

<table>
<tr><td rowspan="4">c) Technical Member</td><td>Tribunal (NCLT)</td><td>Appellate Tribunal (NCLAT)</td></tr>
<tr><td>Sec 409(3)</td><td>Sec 411(3)</td></tr>
<tr><td>CMA in Practice with at least 15 years of service</td><td>CMA in Practice or Employment</td></tr>
<tr><td></td><td>25 year or more in prescribed area</td></tr>
<tr><td>d) Company Liquidator</td><td colspan="2">Sec 275(2)
↓
Court shall appoint Liquidator from the list of panels
↓
Include CA, CS, CMA or firm or body corporate having
↓
10 years or more experience in Company Affairs.</td></tr>
<tr><td>e) Administrator</td><td colspan="2">Sec 259 (sick companies)
↓
Tribunal → List of Panel maintained by CG</td></tr>
</table>

	⬇ CA, CS, CMA, body corporate, firm
f) Cost Accountant as Expert	◉ "Expert" has been defined u/s 2(33) of Company Act, 2013. ◉ The term expert includes a Cost Accountant. ◉ Sec 211(2) → SFIO shall be headed by a Director including a list of experts having knowledge of Banking, Corporate Affairs, Taxation, Forensic Audit, Capital Market, Law, IT or any other field ⬇ He can be treated as a 'expert' Wherever the term expert is used in Companies Act there a reference is made to CMA's also.
g)	Cost Accountant → Registered Valuer & (Sec 247) → Appearance before Tribunal → Mediation Conciliation

Code of Professional Ethics

- Credibility of Information
- Professionalism
- Quality of Service to the highest standard of Performance
- Confidence

Every Cost Accountant Professional should have the aforementioned objectives

5 Fundamental Principles of Cost Accountant

- **Integrity** → **Cost Auditor should be honest & straight forward**
- **Objectivity** → **He should be fair & impartial**
- **Competence** → **He should exercise due skill & care**
- **Confidentiality** → **He should not leak client confidential information at any cost**
- **Professional Behavior** → **He should exhibit professional behavior**

Professional & Other Misconduct		
First Schedule	Part I	Professional misconduct in relation to CMA in practice
	Part II	PM in relation to members of Institute in service
	Part III	PM in relation to members of Institute generally
	Part IV	Other misconduct in relation to member of Institute generally
Second Schedule	Part I	PM in relation to CMA in practice
	Part II	PM in relation to members of the Institute generally
	Part III	Other misconduct to members of Institute generally

Part I [FIRST SCHEDULE]
(PM in relation to CMA in practice)

a. Allows any person to practice in his name

⬇

[CMA in Practice + Partner / Employee]

b. Pays/Agrees to pay

⬇

Share / Commission / Brokerage in his fees for professional work

⬇

[Member of Institute or Partner / Partner's representative]

c. Accept/Agrees to accept

⬇

any part of the profit of professional work of a person <u>not a member of Institute</u>

If done in accordance with point no. (2) than allowed

d. Partnership with a person in or outside India

other than CMA in practice or members of other professional body

e. Secure his Professional works (any Professional Business)

any person other than his Employee or his Partner [Pt. 2, 3, 4]

f. Solicit Client or Professional work

Advertisement / Interview / Circulars / or any other means

Refrain from other CMA in practice

Tender

g. Advertise his professional attainment / services / expression / designation

Visiting Card, Professional Documents, Letter Head, Sign Board etc.

Other than CMA or degree recognised by Law or other professional degree (such as CA/CS)

Part II [FIRST SCHEDULE]

(PM in relation to member of Institute in Service)

Shares of emoluments in employment	Accept / agrees to accept
	Profit or gain
	Lawyer / Cost accountant / broker or agent
	Commission / gratification

Part 3 [FIRST SCHEDULE]

(PM in relation to member of Institute generally)

- **Not fellow act as fellow**
- **Don't supply information called for by Institute, Council, Committee etc.**
- **Gives wrong information in Tender, interview or another CMA**
  ⇩
  To attain professional work

Part 4 [FIRST SCHEDULE]

(OM in relation to member of Institute generally)

Held guilty by Civil/Criminal court

↓

for any offence

↓

Imprisonment ≤ 6 months

Disrepute the profession or institute

↓

By his action or work

↓

whether professional or not

Part I [SECOND SCHEDULE]
(PM in relation to CMA in practice)

(1)	Disclose any information acquired during course of his engagement ⬇ without consent of client or if required by Law in force
(2)	Certifies in his name or firm name ⬇ Report of examination of cost records ⬇ If not done by employee / partner / firm or any other CMA in practice
(3)	Permits his name used in relation to

	estimate of cost / earnings of any future transaction ↓ which leads to a belief that the forecast is accurate
(4)	Expression or Opinion ↓ Cost / Pricing statement ↓ Business / Enterprise ↓ Substantial Interest
(5)	fails to Disclose any material facts known to him ↓ Professional capacity
(6)	fails to report material misstatement in the cost / pricing statement known to him ↓ Professional capacity
(7)	grossly negligent in conduct of Professional Duties
(8)	fails to obtain sufficient information necessary for expression of opinion
(9)	attention to material departure from cost accounting principles & procedures
(10)	Fails to keep money received from client other than fees for professional work for use for the purpose intended within stipulated time

Part II [SECOND SCHEDULE] (PM in relation to member of Institute generally)
contravenes any provisions of the Act or guidelines by the Institute / Council
Being an employee of the company / firm / person ↓ Disclose confidential information acquired during the course of employment ↓ Except if required by Law or if permitted by employer
Give any false information in any statement, firm, return submitted to the institute, council, committee etc.
defalcates / embezzles money received in Professional capacity

Part 3 [SECOND SCHEDULE]

(Other misconduct in relation to members of the Institute generally)

Guilty of offence by any civil/criminal which is punishable with imprisonment of more than 6 months.

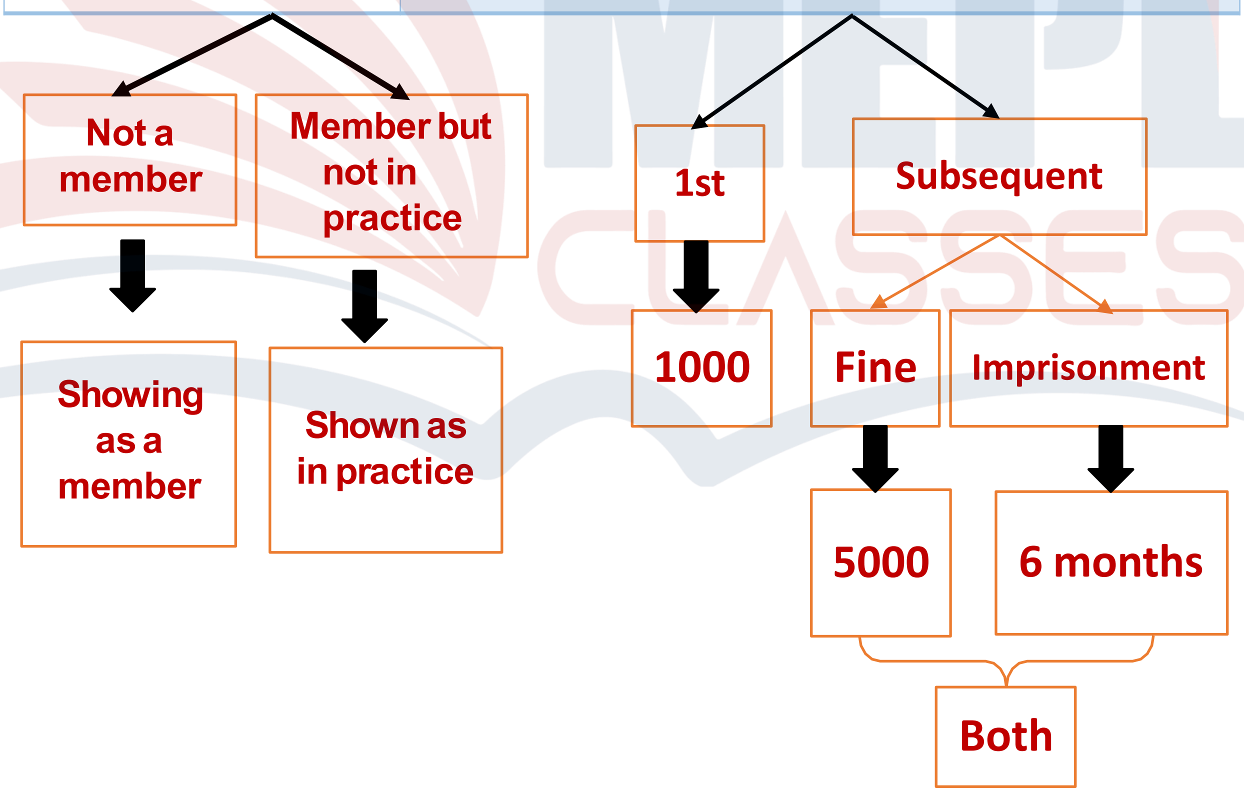
Note:

Both in Schedule First & Second it may be noted that it is said that if the cost accountant or member of institute is guilty of offence

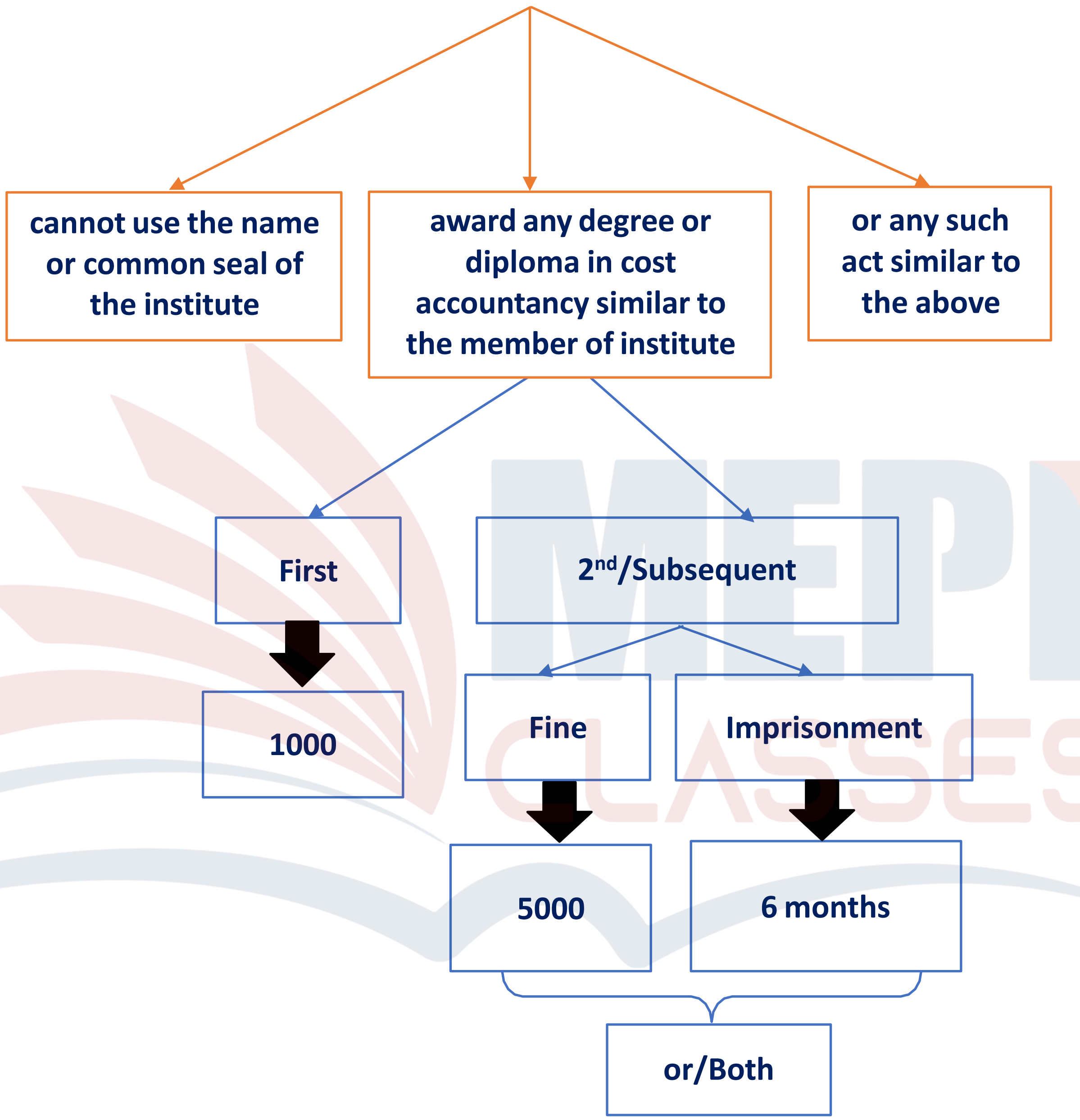
(Which is punishable) word is used That means if he is imprisoned or not it does not matter.

Ex:	Mr X committed a robbery for which there was a provision in Law for fine or imprisonment of 1 year. He was released by court on imposition of five of ₹ 5 Lakh but no imprisonment. ↓ Since he is guilty of such offence ↓ Then he is found / deemed guilty of other misconduct

Section – 24:	If not CMA → Shows CMA



Section – 25:	Penalty for using the name or awarding degree of cost accounting



Section 26:	**No company shall do cost accountancy work**

No company

Any contravention

1000

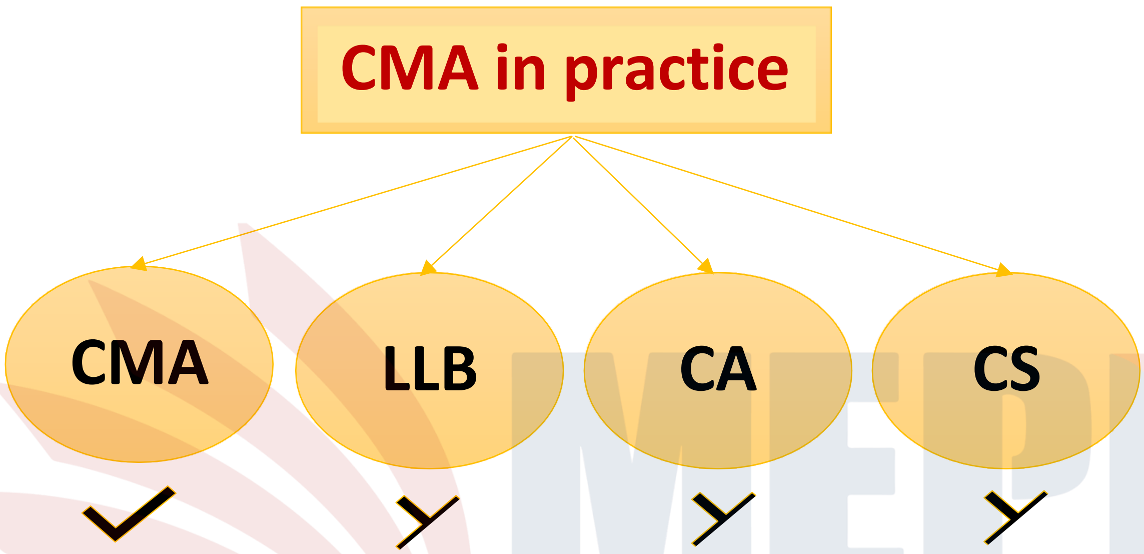
5000 + Imprisonment 6 month

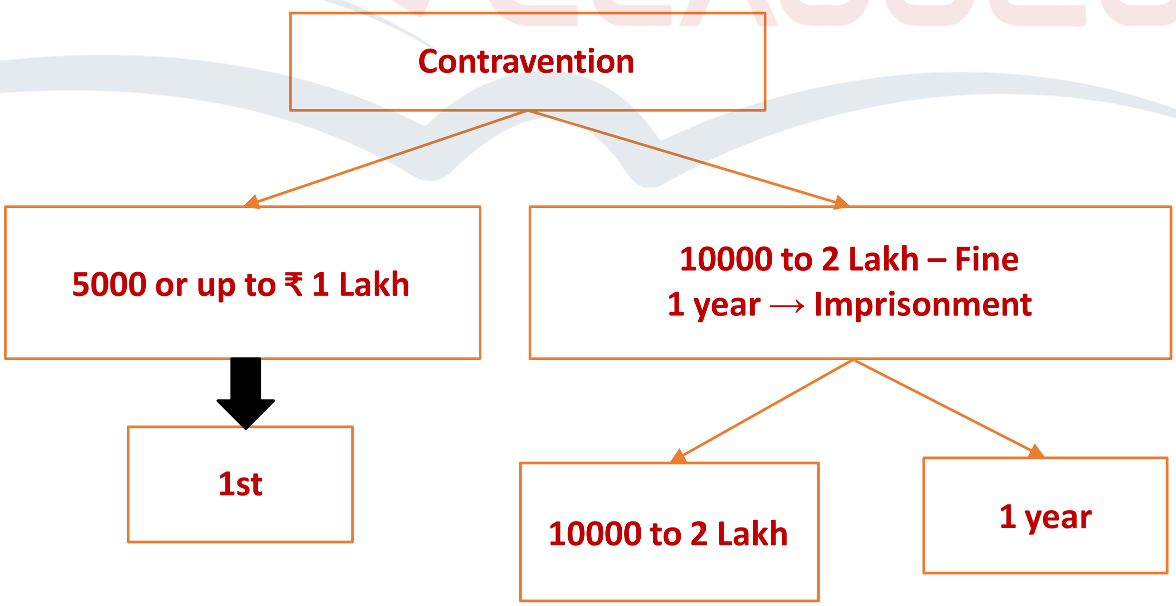
Officer of company

LLP → `		
LLP → Partner Company ✗		
Allowed		Body Corporate
Firm (PF/LLP)	Individual	Company
~~**Partner Company**~~		Firm/LLP

Section 27:	Unqualified person shall not sign the documents

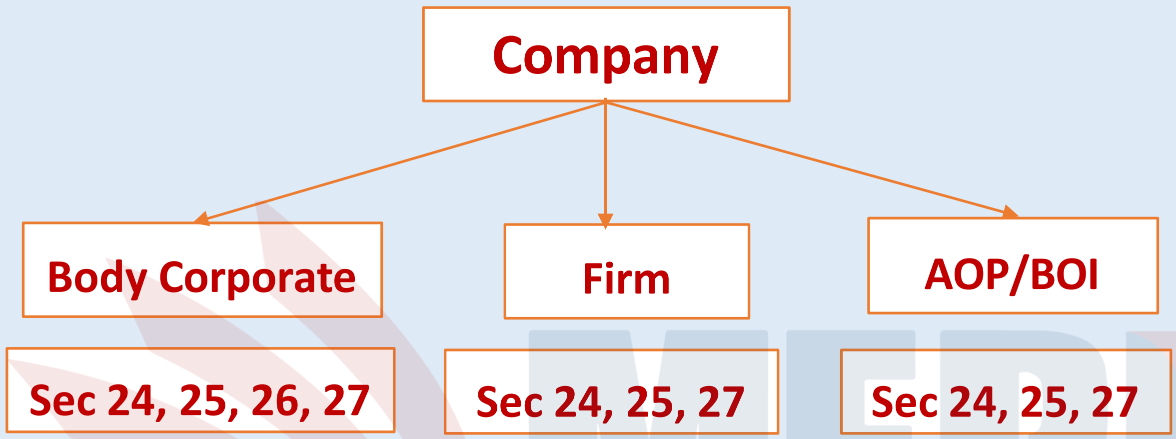
	No person other than the member of the institute
	On behalf of CMA in practice or firm of CMA in practice





Section – 28:	**Offences by the companies**

If offence done by company, then the fine shall be imposed on the company as well as the officers / employee who act on behalf of the company → If proved guilty i.e., if proved that the offence was conducted with knowledge of the officer, employee or management / director of company.



Section – 29:	No person shall be prosecuted under the act unless a complaint is made by council or CG.

SPACE FOR NOTES

SPACE FOR NOTES

SPACE FOR NOTES

CHAPTER – 4 OVERVIEW OF COST ACCOUNTING STANDARDS AND GACAP

COST ACCOUNTING STANDARDS

- **Definition:**

- **Cost Accounting Standards are guidelines for the companies [for the management] that specify the cost accounting treatment for various cost elements, minimum disclosure requirements and ensure the comparability, consistency, and completeness of cost records. These standards are designed to achieve uniformity and consistency in cost accounting principles and practices.**

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

UTILITIES OF COST ACCOUNTING STANDARDS

- **The Cost Accounting Standards:**

  (i) provide a structured approach to measurement of costs in manufacturing process or service industry;

  (ii) integrate, harmonize, and standardize cost accounting principles and practices;

  (iii) provide guidance to users to achieve uniformity and consistency in classification, measurement, assignment, and allocation of costs to products and services;

  (iv) arrive at the basis of computing the cost of product, activity, or service where required by legal or regulatory bodies;

  (v) enable practicing members to make use of Cost Accounting Standards in the attestation of General-Purpose Cost statements; and

  (vi) assist in clear and uniform understanding of all the related issues by various user organizations, Government Bodies, regulators, research agencies, and academic institutions.

LIST OF COST ACCOUNTING STANDARDS [CASs]

- The structure of Cost Accounting Standard consists of Introduction, Objectives of issuing standards, Scope of standard, Definitions and explanations of the terms used in the standard, Principles of Measurement, Assignment of Cost, Presentationand Disclosure.

- So far, the Institute has released 24 Cost Accounting Standards [CASs].

GUIDANCE NOTES ON COST ACCOUNTING STANDARDS

- The Institute had issued guidance notes on the Cost Accounting standards, from time to time, making it more explicit to understand the standards and for better application of the same in the record keeping and audit procedures.

- Normally the guidance notes are greatly required in the respect of the standards dealing with specific elements of cost, they may also be issued in respect of specific purpose standards also.

- The Guidance Notes deals with principles and methods as provided in the respective CAS and practical aspects in connection with the subject matter of that CAS, as applicable in the determination of material cost of a product or service etc. So far, the Institute has issue 13 Guidance Notes on various issues.

Sl. No.	TITLE
1.	Guidance Note on CAS-2 (Revised 2015) Capacity Determination
2	Revised Guidance Note on Cost Accounting Standard on Cost of Production for Captive Consumption (CAS-4)
3.	Guidance Note on Cost Accounting Standard Material Cost (CAS-6)
4.	Guidance Note on Cost Accounting Standard on Employee Cost (CAS-7)
5.	Guidance Note on Cost Accounting Standard on Cost of Utilities (CAS-8).
6.	Guidance Note on Cost Accounting Standard on Packing Material Cost

	(CAS-9)
7.	Guidance Note on Cost Accounting Standard on Direct Expenses (CAS-10).
8.	Guidance Note on Cost Accounting Standard on Administrative Overheads (CAS-11).
9.	Guidance Note on Cost Accounting Standard on Repairs and Maintenance Cost (CAS-12).
10.	Guidance Note on Maintenance of Cost Accounting Records for Construction Industry Including Real Estate and Property Development Activity
11	Guidance Note on Treatment of Costs Relating to Corporate Social Responsibility (CSR) Activities
12.	Guidance Note on Cost Accounting Standard on Cost-of-Service Cost Center (CAS-13)
13.	Guidance Note on Compilation Engagements by a Cost Accountant

- These Guidance Notes explain in detail and clarifies on the various requirements of compliance of the relevant standards and willhave the sections of introduction, scope, definitions and then the specific guidance on the treatment and disclosure aspects.

- Students are advised, like in the case of standards, to thoroughly go through all the guidance notes on standards, issued by the Institute for better understanding of the standards and their compliance.

The guidance notes on the standards dealing with specific elements of cost will normally have the following Chapters / sections,elaborating the contents of the respective CAS, in the same logical sequence, as in the standard:

1. Introduction
2. Definitions
3. Principles of Measurement

4. **Assignment of Cost**
5. **Presentation**
6. **Disclosures and**
7. **Annexures, as the need may be.**

GENERALLY ACCEPTED COST ACCOUNTING PRINCIPLES (GACAP)

- **Introduction**
- **The compilation of Generally Accepted Cost Accounting Principles (GACAP) by the Institute of Cost Accountants of India is a unique**
- **effort to record principles and practices in the discipline of Cost Accountancy in India.**
- **The Expert Group constituted by the Ministry of Corporate Affairs acknowledged the existence of an un-codified set of generallyaccepted cost accounting principles in use in Indian industries and by the practicing cost accountants for attestation of Cost Statements.**
- **The Expert Group suggested that the principles be codified to provide a formal basis for the practice of Cost Accounting.**
- **The Expert Group also recommended review of alternate treatment of items in cost accounting thus eliminating needless diversities in practice leading to the development of cost accounting standards.**
- **The Ministry of Corporate Affairs decided to implement the recommendations of the Expert Group and notified the Companies(Cost Records and Audit) Rules, 2014 on 30th June, 2014.**

- **These Rules introduced a common set of record rules for industries other than regulated industries specified in the Rules, in place of industry specific rules in vogue earlier.**

- **The Rules require every company to which the rules apply, including all units and branches thereof, to keep cost records in respect of each of its products and activities on regular basis.**

- **The cost records are to be maintained in accordance with the generally accepted cost accounting principles and cost accounting standards issued by the Institute of Cost Accountants of India to the extent these are found to be relevant and applicable. The variations, if any, are to be clearly indicated and explained.**

- **GACAP, the Companies (Cost Records and Audit) Rules, 2014 require maintenance of cost records according to GACAP and Cost Accounting Standards gave the mandate for a compilation of GACAP.**

The objectives of this document are:

- to codify the GACAP as applied in the Indian industry;
- to narrow down diversities in cost accounting practices facilitating the process of development of cost accounting standards;
- to provide a reference source to industry and practitioners in preparation and attestation of Cost Statements, where specific cost accounting standards are yet to be issued;
- to provide a reference source to all the stakeholders in the understanding and interpreting the cost statement; and,
- to provide a base for monitoring the evolution of new concepts and practices in cost accounting and
- to codify them as and when they become generally accepted.

SCOPE

- The scope is to codify the cost accounting principles to be followed by business and other entities in India in preparing and presenting cost information – more particularly the General-Purpose Cost Statements covered by Cost Audit.

- This document also encompasses the generally accepted cost accounting practices presently being followed by such entities.

NATURE OF CONTENT AND FORMAT

1. This document titled Generally Accepted Cost Accounting Principles (GACAP) contains a summary of the Cost accounting principles currently followed by business entities in India in preparing and presenting cost information in the context of general-purpose cost statements for statutory reporting and covered by Cost Audit.

2. It explicitly incorporates the principles already contained in the Cost Accounting Standards 1-24 issued by the Cost Accounting Standards Board (CASB) in India without necessarily repeating them.

3. In areas not covered by the standards, it reflects the cost accounting principles found in the Companies (Cost Records and Audit) Rules, 2014.

4. Where somewhat conflicting principles have been laid down by the Companies (Cost Records and Audit) Rules, 2014 in different industries, attempt has been made to harmonize the principles so as to evolve a generally acceptable framework.

   Where use of alternate principles is sanctioned by the Rules or where alternate principles are applied in practice in the absence of explicit guidance in Rules, the alternates have been mentioned with an indication of the preferred practice.

5. Because the Rules were framed at different points of time spread over many years, it is likely that the principles contained in the Rules and the practice based on them do not reflect current concepts. In such cases, the document reflects the current concepts.

6. It also reflects the Cost Accounting Principles contained in the Guidance Notes and other publications issued by ICAI from time to time.

7. Cost Accounting principles which are gathering wide spread acceptance in Indian Companies for management reporting, even though not adopted for statutory cost reporting (for example, Activity Based Costing), are mentioned with suitable caveats regarding their lack of applicability for general purpose cost statements for statutory reporting, where applicable.

8. The document stipulates the main principles in bold letters followed by explanation in normal type.

CONCEPTUAL FRAME WORK

- There is a need for a conceptual frame work that underlies the GACAP detailed in the succeeding sections. The conceptual frame work, as the name suggests, is a frame work and not a superset of cost accounting principles.

- It does not attempt to lay down a principle for any particular costing issue or to amplify the GACAP. The frame work helps to understand the GACAP that follow, in the appropriate perspective and guides in modifying them or developing new principles;

- (a) Focus on drivers of value

- **Costing is necessary for an informed understanding of the organizational drivers of cost, revenue, profits and value. Costing has to fulfil this role both in a historical and in a forward-looking context.**

- **(b) Cost for a purpose**

- **Over a long time, it has been recognized that there is a cost concept relevant for a purpose. Thus, external reporting requires historical and full absorption costing while performance evaluation requires attention directing and diagnostic information; planning and decision making requires analytical and predictive information.**

- **It is, therefore, not possible for the same set of cost data to fit all purposes, thereby resulting in a wide range of cost concepts from which preparers and users of cost information choose a concept relevant to the purpose.**

- **(c) Reality driven**

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

- **(d) Materiality and cost effectiveness**

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

- **The degree of detail and accuracy required are governed by the perspective of materiality. From the preparers' viewpoint there is the** need to balance the cost of maintaining a cost accounting system with corresponding benefits.

- This is the reason why in a number of places, while dealing with methods of implementing cost accounting principles, the expression "economically feasible way" has been used in this document.

- Any product or activity of an entity which is incidental to its main operations and does not constitute its main line of business and whose total turnover from the sale/supply of such product or activity does not exceed 2% of the total turnover of the entity or ₹ 20 crores, whichever is lower, should be treated as an ancillary product or activity.

- (e) Comparability and consistency

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

- (f) Transparency and auditability

- Since cost information is used generally by various stakeholders like management, regulators and Government with a business outlook, there is a need for transparency regarding the definitions used and sources of data.

- It should be possible for those who wish to review such cost information to follow an audit trail. Auditability of cost information is a prerequisite to the effective use of such information.

PRINCIPLES APPLICABLE TO ELEMENTS OF COST

- The compilation of Generally Accepted Cost Accounting Principles (GACAP) by the Institute of Cost Accountants of India is a unique effort to record principles and practices in the discipline of Cost Accountancy in India.
- The following section deal with GACAP applicable to individual elements of cost.
- Before proceeding with element-wise principles, it is useful to summarize the principles applicable to all elements of cost.

1. When an element of cost is accounted at standard cost, variances due to normal reasons are treated as a part of the element- wise cost. Variances due to abnormal reasons will not form part of the cost.
2. Any Subsidy / Grant / Incentive and any such payment received/receivable with respect to the input cost is reduced from cost for ascertainment of the cost of the cost object to which such amount pertains.
3. Any abnormal cost where it is material and quantifiable will not form part of the cost.
4. Penalties, damages paid to statutory authorities or other third parties will not form part of the cost.
5. Costs reported under various elements of cost will not include imputed costs.
6. Finance costs incurred in connection with acquisition of resources such as materials, utilities and the like will not form part of the cost of such resources.

7. **Any credits or recoveries from employees or suppliers or other parties towards costs incurred by the entity for a resource will be netted against such costs.**

8. **Except otherwise stated, the measurement of costs for cost accounting purposes will follow the same principles as set out in Generally Accepted Accounting Principles, applicable to the concerned entity.**

MATERIAL COST

1. **Material Cost usually includes all costs required to bring the materials to the present condition and location.**

2. **Material receipt is valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited by the taxing authorities) that can be quantified with reasonable accuracy at the time of acquisition.**

3. **Procurement costs are not generally included in material cost. However, those costs which can be directly identified with a material are included in the material cost.**

4. **Development expenses incurred in respect of materials procured is included in the cost of material to the extent that the material procured is the result of such developments.**

5. **Where a material is acquired in exchange for other materials or services supplied, the cost of material acquired is taken as the cost of material supplied or services provided plus other applicable costs such as freight.**

6. Normal loss or spoilage of material prior to reaching the factory or at places where the services are provided is absorbed in the cost of balance of materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal.

7. Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture etc., before the material is received is absorbed in material cost to the extent, they are normal, with corresponding adjustment in the quantity.

8. Where the material procured represents an agricultural produce from own sources, the same is valued at market price or cost where it can be determined with reasonable accuracy.

9. The forex component of imported material cost is converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise will not form part of the material cost.

10. Self-Manufactured Materials (and Self manufactured components and sub-assemblies) are valued at cost including Direct Material Cost, Direct Employee Cost, Direct Expenses, Factory Overheads and share of Administrative Overheads relating to production. Share of other Administrative Overheads, Finance Cost and Marketing Overheads are excluded.

11. The material cost of normal scrap/defectives, which are rejects, is included in the material cost of goods manufactured. This cost not exceeding the normal is adjusted in the material cost of good production. Material cost of abnormal scrap/defectives should not be included in the material cost, but treated as loss after giving credit to the realizable value of such scrap/defectives.

12. Issues of materials are valued using appropriate assumptions on cost flow.

Examples are FIFO, LIFO, and Weighted Average rate.

13. Material Costs are assigned to cost objects on the basis of material quantity consumed where traceable and where not traceable on technical norms or estimates.

14. When material is processed or part manufactured by a third party according to specifications provided by the buyer, the processing/ manufacturing charges payable to the third party is treated as part of the material cost.

15. When the part of the manufacturing operations/activity is subcontracted, the subcontract charges related to materials is treated as direct expenses and assigned directly to the cost object.

16. Cost of materials like catalysts, dies, tools, patterns etc., which are relatable to production over a period of time, is amortized over the production units benefited by such cost.

    Cost of materials with life exceeding one year is included in the cost over the useful life of the material.

17. Where the cost of materials is written off or written down in the financial books as per the accounting policy followed by the entity, such write off or write down amount is not treated as cost.

18. When the material referred to in paragraph 17 above, is subsequently issued, the issue is valued at the original cost in cost accounting records and the difference between the original cost and the carrying amount is presented in the reconciliation statement, wherever, economically feasible.

EMPLOYEE COST

1. Employee cost or Labour cost is ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all benefits.

2. Bonus, whether payable as a statutory minimum or on a sharing of surplus and Ex gratia payable in lieu of or in addition to Bonus is treated as part of the employee cost.

3. Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute is considered as part of the Employee Cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits.

4. Performance Incentives must be accumulated over the entire production and not recognized after the threshold limit for earning the incentive is reached.

5. Separation costs related to voluntary retirement, retrenchment, termination etc. should be amortized over the period benefiting from such costs.

6. Amount payable to employees during the lay off period or for the strike period or during suspension, is not included in cost.

7. Cost of employee share options is treated part of employee cost provided the same is not a notional cost and involves an actual cash outlay.

8. Gratuity, pension and other superannuation benefits, measured using actuarial valuation method or any other methods, are part of Employee Cost.

9. Amortized separation costs related to voluntary retirement, retrenchment, and termination etc. for the period is treated as indirect cost and assigned to the cost objects. Unamortized amount relating to discontinued operations should not be treated as employee cost.

10. Recruitment costs, Training costs and other such costs is treated as overheads and dealt with accordingly.

11. Overtime premium and idle time cost should be assigned directly to a cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime or idle time.

12. Where the employee service is directly traceable to a Cost object, such cost is assigned on the basis of time consumed.

13. When employee costs are not directly traceable to a Cost object, they are assigned on a suitable basis like estimates of time based on time study.

DIRECT EXPENSES

1. The identification of Direct Expenses is based on traceability in an economically feasible manner.

2. Similarly, if an item of the expense does not meet the test of materiality, it can be treated as part of overheads.

3. Expenses incurred for the use of bought out resources are determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited.

4. Other Direct Expenses other than those referred above are determined on the basis of amount incurred in connection therewith.

5. Expenses paid or incurred in lump sum or which is in the nature of 'one-time' payment, is amortized on the basis of the estimated output or benefit to be derived from such expenses.

6. Direct Expenses are by definition directly traceable to cost objects and hence no special principles are involved for them to be assigned to cost object.

UTILITIES

1. The cost of utilities purchased is measured at cost of purchase including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited.

2. The cost of generated utilities includes direct materials, direct labour, direct expenses and factory overheads.

3. Cost of Utilities generated for the purpose of inter unit transfers is arrived as Cost of self-generated utilities with Distribution cost added.

4. Cost of Utilities generated for Intercompany transfer is arrived as Cost of self-generated utilities plus Distribution cost plus share of administrative overheads.

5. Cost of Utilities generated for sale to outside parties is arrived as Cost of self-generated utilities plus Distribution cost plus share of administrative overheads plus marketing overheads.

6. The Cost of Utilities includes Cost of distribution of such utilities.

7. Cost of production and distribution of utilities is determined based on the normal or actual capacity whichever is higher and unabsorbed cost, if any, is treated as abnormal cost.

8. Cost of stand by utility includes the committed costs of maintaining such utility.

9. While assigning cost of utilities, traceability to a cost object in an economically feasible manner is the guiding principle.

10. The most appropriate basis for distribution of cost of a utility to the departments consuming services is to be derived from usage parameters.

REPAIRS AND MAINTENANCE COST

1. The cost of Repairs and Maintenance is the aggregate of direct and indirect cost relating to repairs and maintenance activity.

2. Cost of in-house Repairs and Maintenance activity will include cost of materials, consumable stores, spares, manpower, equipment usage, utilities and other resources used in the activity.

3. Cost of Repairs and Maintenance activity carried out by outside contractors inside the entity will include the charges payable to the contractor apart from the above in-house cost.

4. Cost of Repairs and Maintenance activity carried out by contractors at his premises is determined at invoice or agreed price including duties and taxes and other expenditure directly attributable net of discounts (other than cash discount), taxes and duties refundable or

to be credited. It will also include the cost of other resources provided to the contractors.

5. Each type of Repairs and Maintenance is treated as a distinct activity, if material and identifiable.

6. The cost is measured for each major asset category separately.

7. Cost of spares replaced which do not enhance the future economic benefits of the existing asset beyond its previously assessed standard of performance is included under Repairs and Maintenance cost, when Repairs and Maintenance is considered as a separate cost center, the cost of which is apportioned to user centers.

8. Where a high value spare is replaced, and the replaced spare is reconditioned and such spare is expected to result in future economic benefits, it is taken into stock. Such a spare is valued at an amount that measures its service potential in relation to a new spare, the amount of which will not exceed the cost of reconditioning the spare. The difference between the total of the cost of the new spare and the reconditioning cost and the value of the reconditioned spare should be treated as Repairs and Maintenance cost.

9. Cost of major overhaul is amortized on a rational basis.

10. Repairs and Maintenance cost is traced to a cost object to the extent economically feasible.

11. Where the Repairs and Maintenance cost is not directly traceable, it is assigned based on either of the principles of Cause and Effect or Benefits Received.

PRODUCTION OVERHEADS

1. Overheads comprise of indirect material cost, indirect employee cost and indirect expenses. They are termed indirect because they are not directly identifiable or allocable to the ultimate cost object – usually a product or service – in an economically feasible way.

2. Production Overheads are indirect costs involved in the production process or in rendering services. Production Overheads include administration cost relating to production, factory, works or manufacturing. Production related expenses incurred at corporate office, e.g. design office expenses, materials management and industrial relations will also be covered by the term.

3. The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

4. Since overheads cannot be economically traced to products and services, they are assigned to them on some equitable basis.

5. While assigning overheads, traceability to a cost object in an economically feasible manner shall be the guiding principle. The cost which can be traced directly to a cost object shall be directly assigned.

6. Assignment of overheads to the cost objects shall be based on either of the following two principles;

   (i) <u>Cause and Effect</u> – Cause is the process or operation or activity and effect is the incurrence of cost.

   (ii) <u>Benefits Received</u> – Overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.

7. Secondary assignment of overheads may be done by following either Reciprocal Basis or Non- Reciprocal Basis. While reciprocal basis considers the exchange of service among the service departments, non- reciprocal basis considers only one directional service flow from a service cost center to other production cost(s).

8. It is not a good practice to allocate overheads to Cost Centers/ Cost Objects on the basis of "what the traffic will bear" – that is by size of the user.

9. There is a distinct preference for allocating overheads on the basis of "cause and effect" analysis.

   What or who causes the costs to be incurred is a more rational criterion to assign costs rather than size or benefits received.

10. In case of facilities created on a standby or ready to serve basis, the cost shall be assigned on the basis of expected benefits instead of actual.

11. Production Overheads are usually accumulated under production cost centers to facilitate absorption by products or services.

12. These costs are absorbed by the products on the basis of resources used by the product at the production center.

13. The overheads assigned to the production cost centers are charged to products/ services through an overhead absorption rate for each cost center.

- **Common bases for assignment of Production overheads to Cost Objects are:**

Bases of denominator	Applicability
Unit of Production	When single product is produced or various products are similar in specifications.
Material Cost	Where the overheads are mostly related to material.
Direct employee cost	When conversion process is labour intensive and wage rates are substantially uniform
Direct employee hour	When conversion process is labour intensive
Machine Hour or Vessel Occupancy or Reaction Hour or Crushing Hour etc.	When production mainly depends on performance of the base

- **A preferred approach for assignment of overheads to cost objects is to use multiple drivers instead of a single driver such as machine hour, where feasible.**

14. A preferred approach to assignment of overheads is the assigning of cost of resources to activities and assigning the cost of activities to Cost Objects through use of cost drivers, wherever feasible.

15. Also, there are service cost centers through which the product does not pass through but which provide a support function to the production cost centers.

16. Where the cost of services rendered by a service cost center is not directly traceable to a cost object, it shall be assigned on the most appropriate basis.

17. The most appropriate basis of distribution of cost of a service cost center to the cost centers consuming services is to be derived from logical parameters which could be related to the usage of the service rendered. The parameter shall be equitable, reasonable and consistent.

18. **Charging overheads on the basis of "benefits received" by the various users is preferred. This requires some measure of "receipt of benefit" to be developed.**

19. **Sometimes capacity in a service department is created in anticipation of demand for services. It is appropriate to allocate such capacity costs on the basis of "capacity to serve" rather than actual usage of services.**

Ultimately all overheads must be charged to products of services. Hence the total production overheads of Production Cost Centers are applied to products passing through them using a suitable absorption base.

20. **Before the final step of absorption, production overheads of production cost centers have to be segregated between fixed overheads and variable overheads. The fixed overheads are absorbed by products based on normal capacity or actual capacity utilization whichever is higher. Variable overheads are absorbed by products based on actual capacity utilization. This treatment is in line with Accounting Standard 2 as well.**

21. **Normal capacity is defined in Cost Accounting Standard 2 as the production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance. It is practical capacity minus the loss of productive capacity due to external factors.**

22. **Under-absorbed fixed overheads are charged off to Costing Profit & Loss Account and shown as an item of Reconciliation with financial accounts.**

DEPRECIATION

1. Depreciation, though part of overheads, generally appears as a separate line item in the cost statements instead of being grouped under overheads. This is because of its size in the technology driven business of today and its unique characteristic of being non-cash cost.

2. Amortization of intangible assets tends to be grouped with depreciation because intangible assets themselves are grouped with Fixed Assets in the presentation under Schedule III of the Companies Act 2013.

3. The measurement of depreciation in Cost accounts tends to mirror the practices in financial accounts.

4. However, the treatment of depreciation in Cost Accounts must address the following issues:

   - Depreciation not calculated on period of use basis.
   - Depreciation an idle asset
   - 100% of depreciation on certain class of assets
   - Write-off of small value assets
   - Depreciation on fully depreciated assets
   - Depreciation on revalued assets.

5. Sometimes depreciation in books is not calculated on period of use, for example 50% of annual depreciation is taken for an asset put into use for a day in financial accounts keeping in mind Income Tax provisions. Cost accounts will always use the depreciation computed on period of use basis and take the balance to Costing P & L or reconciliation with financial accounts.

6. Even where 100% of the depreciation is allowed in the first year for income tax purposes, companies are required to use regular rates of depreciation for cost accounting purposes. Even where an entity uses 100% depreciation rates in financial books of accounts, depreciation based on estimated life is used for costing purposes with the difference taken to costing Profit & Loss or Reconciliation with Financial Accounts.

7. Where small value items are written off fully at the time of purchase in financial accounts, the same is generally adopted for cost accounts.

8. In the case of old plants, there is the special case for fully depreciated assets which however continue in regular service. Some entities continue to provide a notional depreciation on such assets for decision making purposes.

9. Depreciation on the amount by which the asset is written up on Revaluation is charged to Revaluation Reserve in financial books. Some entities compute the depreciation on the revalued figure for costing purposes to reflect the true cost of depreciation.

10. It goes without saying that the cumulative depreciation charged in the Cost Accounts against any individual item of fixed asset will not exceed the original cost of the asset.

11. The assignment of depreciation to various cost centers should not pose a problem so long as detailed Fixed Asset records are maintained by the Company. However, there are some common items of fixed assets between cost centers e.g. yard piping carrying products from one process to another, common storage tanks and the like. Depreciation on common assets is apportioned to individual cost center on some suitable basis e.g. yard piping is assigned to the cost center receiving the material.

ADMINISTRATIVE OVERHEADS

1. Administrative overheads are the aggregate cost of resources consumed in activities relating to general management and administration of an organisation.

   The principles of measurement of Material Cost, Employee Cost, Utilities, Repairs & Maintenance and Depreciation found in the respective standards will apply if included in administrative overheads.

2. In case of leased assets, if it is an operating lease – the entire rentals will be treated as a part of administrative overheads, while in case of a financial lease – the finance cost portion will be segregated and treated as a part of finance cost.

3. The cost of software (developed in house, purchased, licensed or customized), including up- gradation should be amortized over its useful life.

   When hardware requires up-gradation along with the software, it is recommended to use compatible estimated lives for the two sets of cost.

4. The cost of the administrative services procured from outside is determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable net of discounts (other than cash discount), taxes and duties refundable or to be credited. The assignment of administrative overheads to cost objects is based on either of the principles of Cause and Effect or Benefits received, if it is not directly traceable.

   The cost of shared services is best assigned to user activities on the basis of actual usage, infrastructure costs on the basis of readiness to serve and general management costs on a rational basis. For e.g.: Number of employees, turnover, investment size etc.

5. Since most administrative costs are fixed in nature, it is preferable to change them to users on "readiness to serve" basis such as installed capacity, budgeted sales etc. rather than actual production or actual sales. Even the drivers mentioned in (9) above can be on the basis of expected driver qualities rather than actual.

SELLING AND DISTRIBUTION OVERHEADS

1. Selling costs can be recorded in a manner which will facilitate customer / product profitability analysis, as appropriate. Thus, selling costs can be identified to markets, distribution channels, territories, salesman etc., before being assigned to customer / product as applicable.

2. The acceptable bases for apportionment of common selling costs to customers / products are:

   a) Weight

   b) Units / equivalent units

   c) Value of goods

   d) Any other appropriate and equitable basis

3. The acceptable bases for assigning common transport costs to products are:

   a) Weight

   b) Volume of goods

   c) Tonne km

d) Units / equivalent units

e) Value of goods

4. The transportation costs assigned to products are charged to units based on some measure which factors in the distance e.g. tonne km.

INTEREST AND FINANCE CHARGES

1. Interest and Finance Charges have come to be included in cost of sales though not in cost of production. Such costs are also assigned to products before arriving at margins by product.

2. For the purpose of assignment, Interest charges are grouped under

   - interest on long term funds
   - interest on working capital funds

3. The former is assigned to product lines based on fixed capital investment (including fixed assets and mold and dies) in such product lines. A portion of the interest is also charged to outside investments, if they exist, and excluded from cost of sales. For this purpose, it is usual to develop an average cost of long-term funds and apply it to fixed capital investment in each product line.

SALES

1. Cost of sales statements lead right up to margin and hence sales also have to be handled in Cost Accounting.

2. Since costing is always by product, cost accounting requires product wise analysis of sales. This is usually produced by other modules of the enterprise system.

3. What is critical is the value of sales produced by such analysis. Often sales analysis produce invoiced value of sales. What is required for cost accounting is net value of sales net of trade discounts, returns, allowances, volume discounts, special discounts based on market conditions etc.

4. Many of these deductions from sales are transacted through credit notes which also must be processed through the sales analysis to arrive at product wise break up.

5. Some of these deductions from sales may be available only in total and hence may have to be allocated to products on a suitable basis, say, sales value.

6. It is not unusual for businesses to focus on net realization from sales ex-factory gate. This means that freight (both primary and secondary), transit insurance, loading and unloading charges, handling charges and the like are deducted from net sales as arrived at in 3 above to arrive at net sales realization ex-factory gate. This also entails freight and other transport costs not being shown under the head Distribution costs. So long as these costs are shown separately as deductions from net sales value, the practice is acceptable.

7. Companies (Cost Records and Audit) Rules, 2014 require gross sales to be shown in addition to net sales in cost statement. This requires that excise duty, sales tax (VAT) etc is added to net sales to arrive at gross sales by product. However, in view of application of GST, w.e.f. 1/7/2017, the Gross sales becomes Net Sales.

JOINT COSTS

1. Joint Costs are the costs of a production process that yields multiple products simultaneously, for example, in the refining of Petroleum which yields Petrol, Kerosene, Diesel, Naphta, Grease, Tar and several other products or the distillation of coal, which yields coke, natural gas, and other products.

2. The costs of the common process are the joint costs.

3. Joint costs are allocated

   a) Based on a measure of the number of units, weight, or volume of the joint products, or

   b) Based on the values attributed to the joint products.

4. By-product is a special case of Joint Product where one or more of the joint products has minor value compared to others.

5. Such by-products are generally valued at their value at the split-off point with such value being credited to the costs of the main product. The split-off point value is arrived at on the basis of the ultimate realizable value of the by-product less the post-split-off costs.

COMMON COSTS

1. A common cost is the cost of operating a common facility, activity or service or that is shared by two or more cost objects.

2. The common cost is generally lower than the stand-alone individual cost to each cost object was the facility not shared.

3. Common costs are therefore allocated to each cost object based on the individual costs of the cost object.

PRESENTATION AND DISCLOSURE

- Generally, the presentation requirements of cost information for statutory purposes are laid down in the respective rules. Similarly, the requirements of reporting for regulatory purposes are laid down by the regulatory agencies. Managements stipulate the presentation formats for managerial purposes. It is therefore not considered necessary to lay down any model statements or formats in this document.

- However, it is considered appropriate to stress certain disclosure practices which are generally applicable.

  a) Cost Statements must contain, besides total cost, unit cost per unit of output.

  b) Output quantities with unit of measure must appear in the Cost Statements.

  c) Input costs are best broken up as quantity and rate.

  d) The basis of valuation of inputs must be stated.

  e) The basis of distribution of costs to cost objects or cost centres must be disclosed.

  f) Costs incurred in foreign currency must be stated separately.

  g) Any costs excluded must be disclosed.

h) Any credits or recoveries netted against cost must be disclosed separately.

i) Transactions with related parties must be highlighted or disclosed separately.

j) Cost elements, which are material for a product or activity, must be disclosed separately.

k) Cost details of all ancillary products or activities may be maintained under a miscellaneous group and disclosed appropriately.

l) Changes in the costing principles and methods applied must be disclosed with the effect.

CONCLUSION

- This document contains a discussion of the generally accepted cost accounting principles in the context of today and the times gone by. It must be understood that cost accounting principles and methods of applying them are in a constant flux influenced by fresh thinking by experts, regulatory influences, parallel developments in financial accounting standards and the like.

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Chapter – 5: Cost Auditing Standard

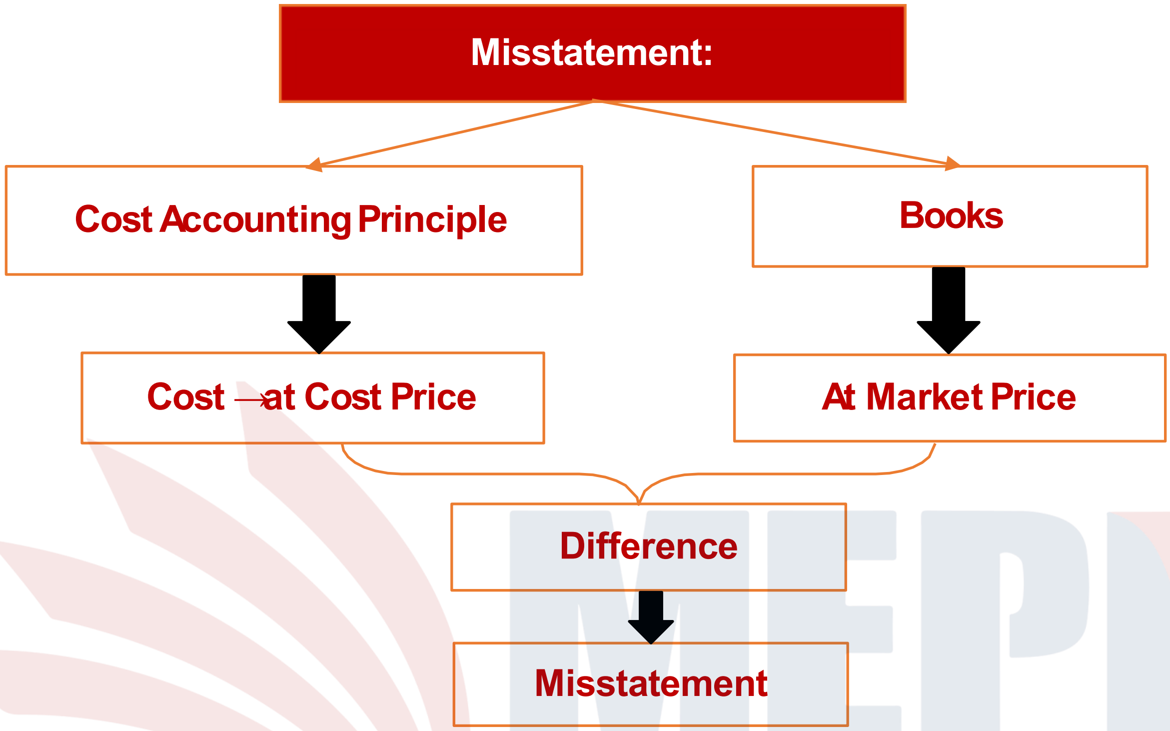
Sec 148(3):	Cost Auditor should conduct the Audit on the basis of Cost Auditing Standard. ⬇ Cost Auditing Standards are issued by CASB (Cost Auditing & Assurance Standard Boards)

Total Standard's	Cost Auditing Standard – 101 ⬇ Planning an Audit of Cost Statements
	Cost Auditing Standard – 102 ⬇ Cost Audit Documentation
	Cost Auditing Standard – 103 ⬇

	Overall objective of the independent auditor & the conduct of Audit in accordance with the Cost Auditing Standard
	Cost Auditing Standard – 104 ⬇ Knowledge of business processes & business environment
Cost Auditing Standard – 101	**Objective/Scope** Establishing an overall strategy & Audit plan ⬇ For conduct of Audit in effective & efficient manner
	Audit Plan A record of planned nature, timing & extent of Risk Assessment Procedure ⬇ Audit procedures at the assertion Level in response of Audit Risk ⬇ Example – Jute Industry
	Audit Risk

	Audit Risk =Material Misstatement +Detection Risk	
	Audit risk is a risk that the auditor might give an inappropriate opinion	
	of a Cost Statement that is materially misstated	
	Material Misstatement	
	Inherent Risk	**Control Risk**
	Risk of assignment, measurement & disclosure of a particular cost in a cost statement	Risk of measurement, assignment & disclosure of cost
	That could be material	That could be material
	Before consideration of any related control	That will not be prevented, corrected or detected on timely basis
		By entity's internal, operation or management control

Detection Risk	The risk that a misstatement might not get detected by the risk assessment procedures followed by the cost auditor. The misstatement is material in nature.



	Preliminary check ⬇ Appointment Letter ⬇ as per the Act/Rules ⬇ Ethical Requirement
	Previous Auditor ⬇ Report ⬇

Overall Audit Strategy	Also, Reliance on companies Internal Auditor & Financial Auditor
	Business & its environment
	Nature & Scope
	Statutory Deadlines ✓ Completion of Audit ✓ Report of Audit ✓ Format
	Relevant Factors determining the direction of Audit ↓ ERP/IT software whether working properly or not
	Nature, Timing & Extent of resource required ↓ Resource required for conducting the Audit

The Auditor shall communicate with the previous auditor if the audit was conducted by different firm.

Initial Engagement	Same or initial is Recurring ↓ Audit plan & strategy
	Additional Consideration ✓ Previous Auditor ↓

	Communication & Report ✓ Why he was selected ⬇ Communication with management ✓ SAAE w.r.t Opening balance ✓ Audit Strategy

Cost Auditing Standard – 102

OBJECTIVE

- **Sufficient & Appropriate record** → **Basis of Cost Audit Report [CRA-3]**
- **Audit was planned & performed in accordance with the Cost Auditing Standard (+) legal & regulatory framework**

Audit Documentation	means record (physical / electric form) +working papers prepared to or by, obtained or retained by the Cost Auditor ↓ Performance of Audit

Audit File:	one or more folder containing the record of audit documentation.

Working papers	Record documents / etc of evidence obtained during the course of Audit

	Which shall give an assurance that the audit was conducted in accordance with the auditing standard.

Requirement	(1)	✓ Audit procedures performed ✓ Relevant Audit Evidences obtained ✓ Conclusion reached
	(2)	Enable another person to understand (no previous connection with audit) (+) Peer review ✓ Audit procedures perform in accordance with Cost Auditing Standard ✓ Legal & regulatory framework ↓ Performed Audit Procedure ✓ Result of Audit Procedures ✓ Audit Evidence obtained ✓ Significant matters arising, conclusion reached, and professional judgement.

	Checklist

Audit Documentation Content	Auditing Standard + Legal framework + GACAP
	Audit Programme
	Analysis
	Audit Query List
	Abstract of significant contracts of Cost & Revenues
	Letter Third party with confirmation Representation management Considering significant matters
	Copy of Entity Record

Cost Auditing Standard – 103	The objective of this standard is to lay down overall objective of the Cost Auditor and ensuring that the audit is conducted as per the Cost Auditing Standards. **Overall objective of Cost Auditor** **Audit is conducted as per Cost Auditing Standard**

Overall objective of Cost Auditor

Reasonable assurance

Cost statement are free from Material Misstatement (error/fraud)

To enable him to express an opinion

Whether the cost statement are prepared in accordance with the Accounting Policy & framework [CAS/GACAP & other Rules & Regulation]

True & Fair view

- ✓ **Cost of Production**
- ✓ **Cost of Sales**
- ✓ **Margin**

As per the Companies Act

If reasonable assurance obtained

⇩

Issue Report as per the rules prescribed in prescribed form

If reasonable assurance not obtained

⇩

Qualify or Disclaimer of opinion

⇩

In the report

The Cost Auditor may give suggestions wherever necessary

Cost Audit: Auditor as per the Cost Auditing Standard

Management / Company: Cost statement must be prepared as per the Cost Accounting Standard or GACAP

Auditor → Auditee

Auditor ↓ CMA in practice

Auditee ↓ Organization of which Cost Audit is conducted

Non-Compliance: Non-Compliance with the

- Rules
- Regulations
- CAS
- GACAP
- Cost Auditing Standard

personal misconduct ≠ non-compliance

Intentional/Unintentional		Self-Consumption	
~~Follow~~	~~Follow~~	Cost Price	At Market Price

Personal Misconduct	When the TCWG / Top Management or management have done some act which is not affecting the books of A/c or Records such as cost records etc but affecting the image of company or the employees or the management.

Performance Managemen t	Management's compliance with the regulations & rules for preparing Cost Record / Statement.

Personal Misconduct	This is not the duty of Cost Auditor

Requirement of Cost Auditing Standard 103	**(1)** Independence ⬇ Ethical requirement
	(2) Cost Auditing Standard ⬇ Comply
	(3) Understanding of the entire content / text of each of the Cost Auditing Standard
	(4) Shall give a report of compliance with all the standard ⬇ Only if he is complying ⬇

	[i.e., He should not give false statement of compliance with standards]
	(5) Exceptional circumstances ↓ Can depart from Auditing standards ↓ Perform alternative audit procedure
	(6) Professional Scepticism ↓ Cost statement is materially misstated
	(7) Sufficient Appropriate Audit Evidence AR↓ → Express an opinion
	(8) Professional Judgement ↓ Conducting & Planning the Audit
	(9) Cost Reporting framework (CAS/GACAP) ↓ Company Act & Rules thereof
	(10) If there is suspected non-compliance, he shall not conduct the Audit.
	(11) If the auditor is unable to achieve the overall objective ↓ Give an opinion in the report of the same.

	Modified opinion

Professional Skepticism: -

- Questioning Mind → Audit Evidence → Not be contradictory with the responses received from management or TCWG
- Representation made by management → Not sufficient Appropriate Audit Evidence to enable him to form an opinion
- Audit Evidence should be conclusive rather than persuasive

Limitation to Audit Evidence [Reasonable Assurance]

- **Sampling**
- **Inherent Limitation**
- **Persuasive in nature rather than conclusive**

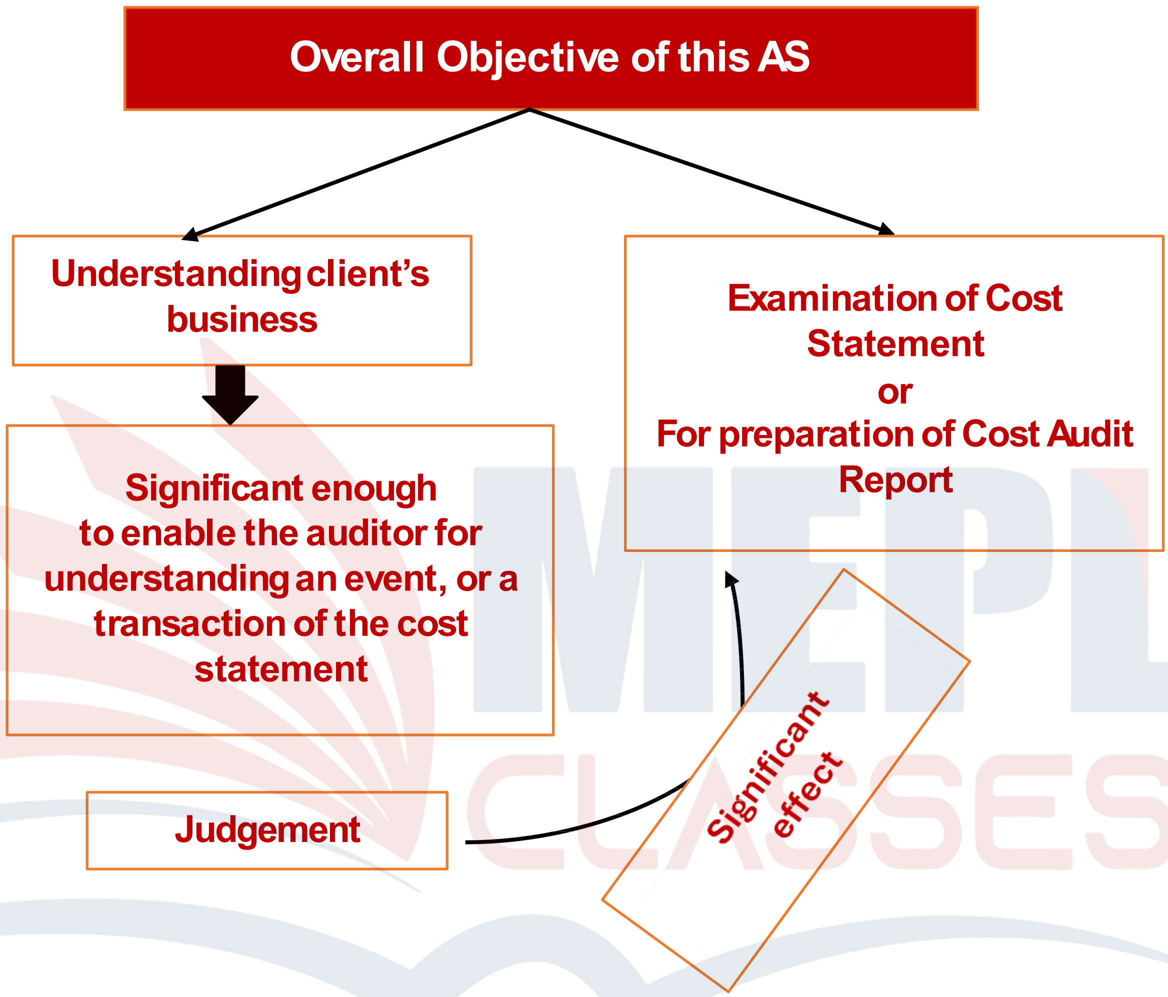
3 elements of Professional Skepticism

- **Auditor's attributes**
  - [For ex: Past experience, dealing with critical situation, and other skills]
- **Auditor's mindset**
- **Auditor action permeate the entire audit process and are integral to the audit quality**
  - The Better the action the better the quality of audit

Professional Skepticism reduces the risk of

- Overlooking → Unusual circumstances
- Over generalizing when drawing conclusion
- Using inappropriate assumption

Cost Auditing Standard – 104



Requirement

I. Knowledge of

- Business
- Business Process
- Business Environment

II. Entity & its Environment

- Nature of entity → Governance (TCWG)
- Relevant industry & its applicable cost & financial reporting framework
- Selection & application of Cost Accounting principles
- Measurement & Review of Entity Performance

III. Entity's Internal Control

- Control Environment
- Risk assessment procedure
- Cost Information system / MIS
- Control Activities
- Monitoring of control

IV. IT Environment Control: -

- IT architecture / programme used by the company
- Data access control
- Control on change of Data (such as master Data / file)
- Integrity of information and security of Data

V. Identifying & Assessing the risk of Material Misstatement

- Identify the risk (+) relevant control
  - Material misstatement
- Related party transaction
- Degree of subjectivity of information
- Revision of Risk Assessment Procedure
- Risk is having significant impact on the Business

VI. Documentation

Note – 1

No.	Cost Auditing Standard	Effective Date
101	Planning an audit of Cost Statement	11/9/15
102	Documentation of Cost Audit	11/9/15
103	Overall objective of Independent Cost Auditor and the conduct of Audit in accordance with the Cost Auditing Standard	11/9/15
104	Knowledge of Business, its process & environment	11/9/15

Approval to the Cost Auditing Standard was granted by the MCA u/s 148(3) of the Companies Act on 10/9/15

10/9/15 – Approval

11/9/15 – Effective

Note – 2

International Auditing & Assurance Standard Board (IAASB)

↑

International Federation of Accountant (IFAC) + ICMAI

↑

ICMAI (Founding member)

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Chapter – 6: Audit Programme: [Max 5 marks] or NIL

Example:	Suppose you have an invitation of a marriage. A marriage invitation has a list of programme along with the time.

Example:

Audit programme

1)	**Raw Material Verification**	**3/9 →12.30**	✓
2)	**Electricity cost**	**4/9 →12.30**	✓

Audit programme is a detailed layout of audit plan which contains the exact audit procedures to be applied on exact date on exact item of cost statement by cost auditing team.

- ✓ Checklist
- ✓ Work allocation easy

- ✓ Audit Timely conducted
- ✓ Audit objective is achieved
- ✓ Audit is more effective

Factors in Planning the Cost Audit Assignment

Requirement of Audit personnel

↓

Audit Team Determination

- **Industry**
- **Annual Report (5 years)**

- ✓ Physical Inspection
  - Costing Record
  - Activities

- ✓ Cost Accounting Standard + GACAP
- ✓ Personnel responsible for maintenance of Cost Record
- ✓ Study of Budget/Plan

Documentation of audit procedures and evidence

↓

Cost Auditing Standard – 102

	Quality Control exercised over performance of assignment ✓ Monitoring the preparation of Cost Accounting records. ✓ Reviewing the audit assistants → skill & knowledge ✓ Professional Judgement/scepticism ↓ Accounting & Auditing query & its significant impact on the overall audit strategy [audit plan & procedure] ✓ Professional Judgement ↓ Difference between personnel and deciding level which is appropriate.

1) Product wise

a) Balance of Inventory of FG

MIS Report Product wise

Opening Stock + Production = **Internal Sales**
(+)
External Sales
+
Closing Stock

MIS Report

Product	Opening Stock	Closing Stock	Internal Sales	External Sales	Closing Stock

c) Underutilisation → Management

d) Underutilisation after any addition

2) **Raw Material**

a) Opening Stock + Purchase = Consumption + Closing Stock

b) Input / Output Ratio 2 to 5 years

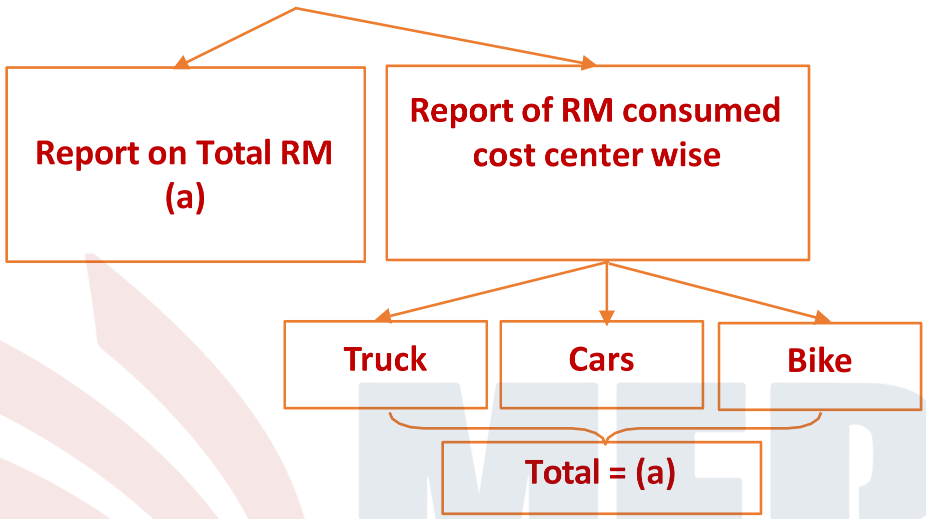
c) Normal loss should be considered = Consumption

d) Residual Raw Material = If unusable = Consumption

e) Research & Development team

f) Fifo / Weighted Average → consistently

g) Expense Chart



h) Local / imported Raw Material separately

2) **Raw Material:**

RM → Storage → Storage Rent

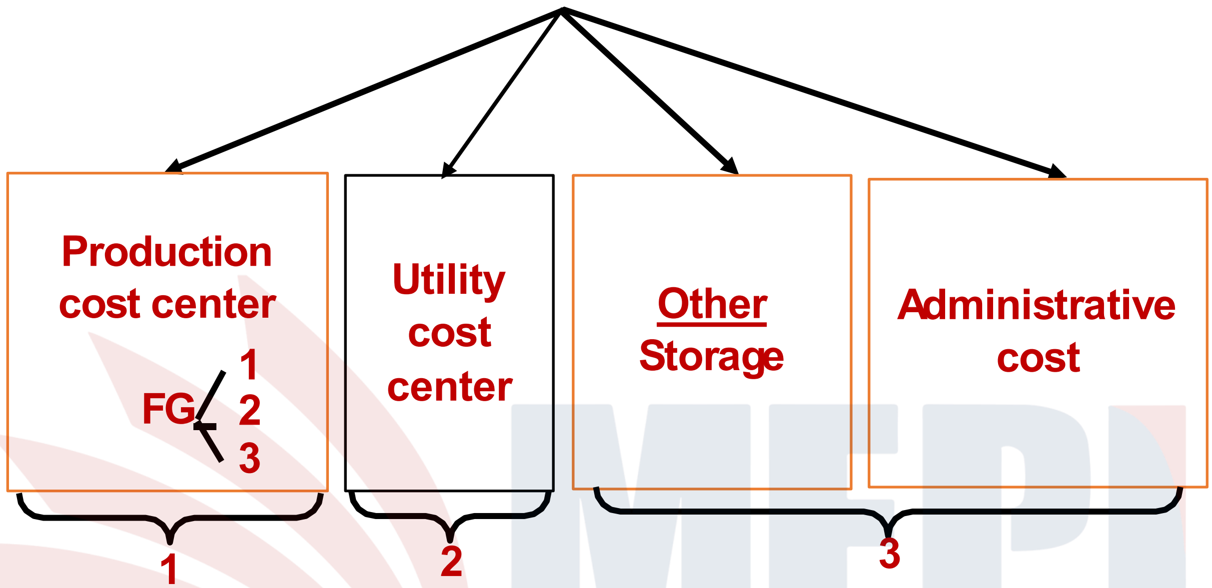
↓

Cost of Material

3) **Key Inventory**

- ✓ Stock position
- ✓ Consumption vis a vis stock
- ✓ Extra stock

(I) All Expenses / Cost should be divided cost center wise

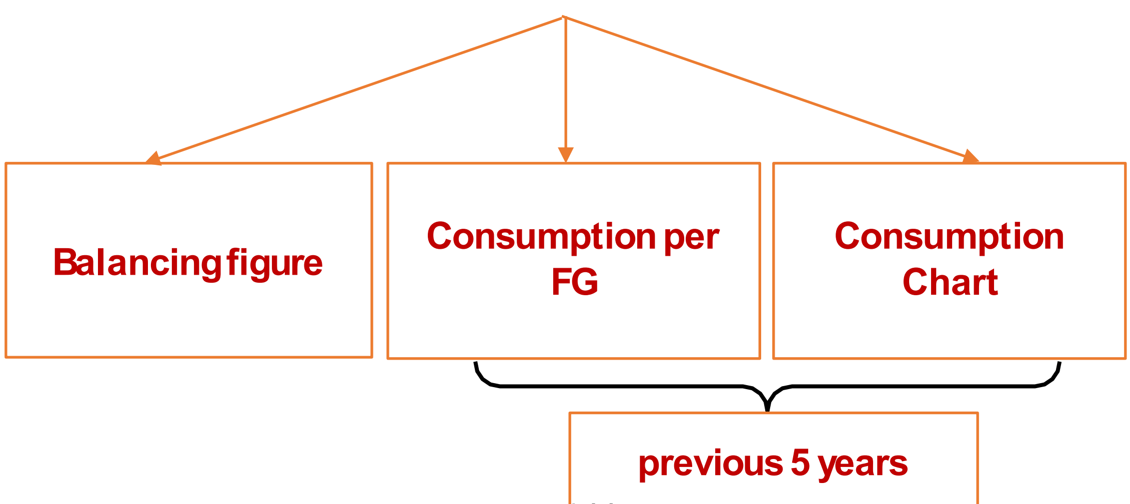


This should be done while preparing comparison chart

(II) Expense chart of expenses / MT of FG of previous 5 years

(III) Expense chart of expense / Rs of the company for previous 5 years

(IV) In case of RM / Utility etc → Extra chart need to prepared



Overall checklist	
1)	Familiarisation with the Company
2)	Company Records
3)	Familiarisation with the organisation of Company
4)	Management profile
5)	Company policy
6)	Sales policy
7)	Production planning & control
8)	Accounting system
9)	MIS
10)	Internal control
11)	Cost record statements report

Checklist of various cost elements for Audit Programme	
1)	Production – Product wise
2)	Raw Material Cost
3)	Key inventory cost
4)	Electricity cost
5)	DM water (Demineralised water)
6)	DG set

7)	Steam cost
8)	Stores & Spares cost
9)	Repair & Maintenance cost
10)	Employee cost
11)	Insurance cost
12)	Depreciation cost
13)	Administrative O/H cost
14)	Selling & Distribution O/H cost
15)	Packing Material cost
16)	Sales value

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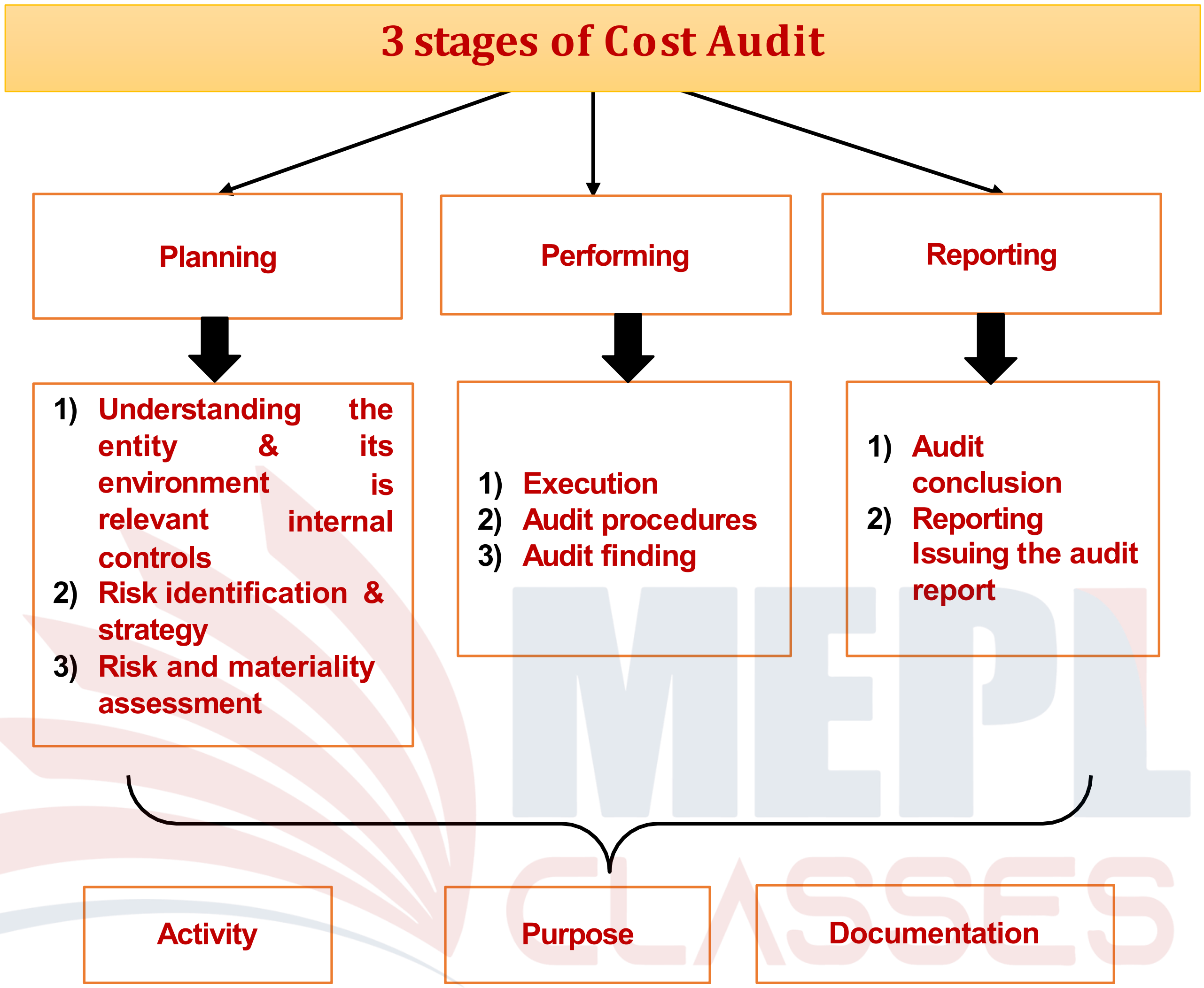
CHAPTER – 7 Audit Documentation & Audit Process & Execution

Audit Documentation
↓
means material or working paper
↓
Prepared by or obtained or retained by the Cost Auditor for the performance of the audit

Audit File
↓
means one or more folders or other storage media in physical or electronic form containing the records that comprise the audit documentation
↓
for specific assignment

Audit working paper
↓
means the record of audit evidence obtained during the Cost Audit. Such document is used to support that audit was planned and conducted in accordance with the Cost Audit & Assurance Standards & other regulatory framework



For the chart of Activity / Purpose and Documentation at various stages please refer chart in page 368

Planning	**Activity 1** Preliminary Engagement Activity
	Activity 2 Planning the audit of Cost Statement
	Activity 3

	Perform the audit procedures
Performing	**Activity 1** Design overall response & further audit procedures **Activity 2** Implement responses to the assessed risk of material misstatement
Reporting	**Activity 1** Evaluate the audit evidences obtained **Activity 2** If additional work required Yes – Again start with planning & performing phase No – Move to Activity 3 **Activity 3** Prepare the Cost Audit Report

PRACTICAL STEPS OF AUDIT PROCESS

STEP-1:	**Objective of Audit & Management Outlook** Auditor should understand from management of the entity whether management is looking for a cost audit just to satisfy the statutory requirement or also to fulfil other objective like: - ✓ Cost reduction ✓ Checking the parameter of Operational efficiency

	✓ Suggesting product diversification or Product mix ✓ Identifying Profit making or loss-making products ✓ Suggesting or improving marketing strategies / decision ✓ Complete revival of Business strategies.

	Preconditions (1)Cost Auditor should understand the following a) Objective of Cost Audit b) Area, nature & scope of Cost Audit c) No. of cost auditor to be appointed d) Applicable reporting framework e) Reporting period f) Statutory deadlines
STEP-2:	(2)Cost Auditor should ensure that management understand its responsibilities: - a. To maintain Cost records b. To present cost statement c. To give unrestricted access to the books & employees d. To give additional information if required by Cost Auditor e. To give necessary representation f. To select & apply the relevant Cost Accounting Principles

	(3) Auditee & the Cost Auditor should agree on Audit Fees & Payment Schedule and sign the audit Engagement Letter.

STEP-3:	**Understanding the Company's Business (key input to make audit plan)** Cost Auditor before making the audit plan should understand the following relating to companies' business ✓ Nature of company's activity, ownership & management structure. ✓ Nature of industry in which it operates ✓ Applicable reporting framework ✓ Companies Production process ✓ Details of subsidiaries, associates & Joint ventures ✓ Purchase & Sales policy ✓ Inventory policy ✓ Internal control system ✓ Internal audit system ✓ Previous year audit report

STEP-4:	**Planning the Audit** Audit plan should include the following: - ✓ Timing (Dates) & Duration (No. of day) of Audit ✓ Level & no. of personnel required ✓ Determining the audit engagement partner

	✓ Deciding materiality levels ✓ Drawing an overall audit strategy & audit plan ✓ Formulating risk assessment procedures ✓ Formulating audit procedures a) Test of Control b) Test of Details c) Analytical procedures d) Assertions e) Management representation

STEP-5:	**Executing the Audit** ✓ Performing the audit procedures as planned ✓ Collecting the audit Evidences & Checking 1. relevance & reliability 2. sufficient & 3. source of such evidences ✓ Preparing draft audit observation & discussions with management ✓ Preparing the final report

STEP-6:	**Audit Documentation** ✓ Documenting audit plan & strategy ✓ Documenting working paper

	✓ Documenting audit evidences ✓ Documenting draft audit observation ✓ Documenting final audit report

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Chapter – 8: Audit Report

Audit Report	
Cost Audit	**Financial Audit**
(1) audit of efficiency of minute details of expenditure ↓ while the work is in progress	Post mortem analysis of Financial of the Company ↓ "Fait accompli"
(2) verification of cost record (cost statement, cost center etc) of the company to examine whether the cost record are prepared as per the relevant Cost Accounting Standard & GACAP	
(3) Error / fraud in the underlying costing records	
(4) Cost Records are maintained in CRA-1 ↓ 32 items (CAS)	
(5) Refer Ch. 2 notes for annexure of CRA-3 ↓	

Part A to Part D	

Objective of Cost Audit

1. Accuracy of Cost Records
2. Cost Accounting Principles have been followed
3. Cost Accounting Procedures has been followed
4. Detection of error / fraud
5. Proper Accounting of Expenditure
6. Decision making
7. Deficiencies or inefficiencies in accounting or utilization of RM, Labour & Expenses / Utility
8. Reduce volume of Audit work for external auditor
9. Morality check of staff

Critical Elements to be included in the Cost Audit Report
(1) Idle time of Machine/Labour ⬇ RM Shortage
(2) Excess quantity of Unutilized RM
(3) Adequacy of the cost record
(4) Policy framed by the management is followed or not
(5) Comparative analysis of profitability, operating efficiency & production ⬇ statistical analysis (past data comparison)

(6) Discussion on rise of Cost of Production
(7) Wastage in production & its avoidance
(8) True & Fair view of Cost of Production

Cost Audit report is to be filled by the company in Form CRA-4 within 30 days of the Receipt of the cost audit report in XBRL format given in the XBRL Rules, 2015 in MCA portal → mca.gov.in

XBRL → annexure

XBRL → Extensible Business Reporting Language

XBRL is a standard for digital business reporting → managed by the international

XBRL international

so that we can use it for the purpose of reporting of financial / business information in digital format which can be accessed globally.

Tagging Feature of XBRL

1. Unique tags in XBRL → Benefits
   - ♣ Consumption & analysis of information in report
   - ♣ Checking of accuracy of data on the basis of predefined rules & definition
   - ♣ Usefulness of data worldwide i.e., Different style, currency & language

- Reliability on the usefulness of the information contained in the report as we are using a standard format

2. Business Information
   - Preparation
   - Validation
   - Publication
   - Exchange
   - Consumption
   - Analysis

   usefulness of Data Tags & Definition i.e., Costing Taxonomy

3. XBRL uses for reporting
   - Reporting for internal & external purpose

     ↓

     Financial / costing information
   - Reporting to all type of regulator

     ↓

     Tax, RBI, Government authority
   - Filing of any loan application or Risk assessment (Credit Rating)
   - Exchange of information between Government Department & Banks

Benefits of XBRL

1. Data Collection & Distribution
2. Cost & Efficiency improvement
3. XBRL uses standard format so can be adopted anywhere easily
4. Helps in preparation, transmission of data among stakeholders / departments etc.

Future of XBRL

1. Beyond regulatory reporting & compliances.
2. Helps in data analytics for decision making
3. Internal reporting
4. Vide variety of reports for future growth
5. Acceptance around the world

Benefits of Costing Data: XBRL

- **Regulators can use the data for policy makings**
- **Confidentiality of Data**
- **Integration of Costing & Financial information** → **So, company can take quick decision**

Costing Taxonomy

Dictionary of all costing elements

Contains the interrelationship of all the costing elements for the purpose of cost audit reporting

Cost Audit Report

Reasonable assurance that there is no fraud / error

True & Fair view

Reasonable assurance

Qualified

There is material misstatement but such material misstatement is not having pervasive effect on the costing records of the company

Adverse

If there is a misstatement and it is having a pervasive effect on the costing records or the auditor is unable to follow its objective

Conversion of Costing Record in to XBRL

- ✓ XBRL enabled software
- ✓ Mapping of costing data with XBRL Tags using the software
- ✓ Integration of XBRL into the existing software such as ERP / Tally

⬇

XBRL report (XBRL software with Tally linking)

- ✓ Web based application

⬇

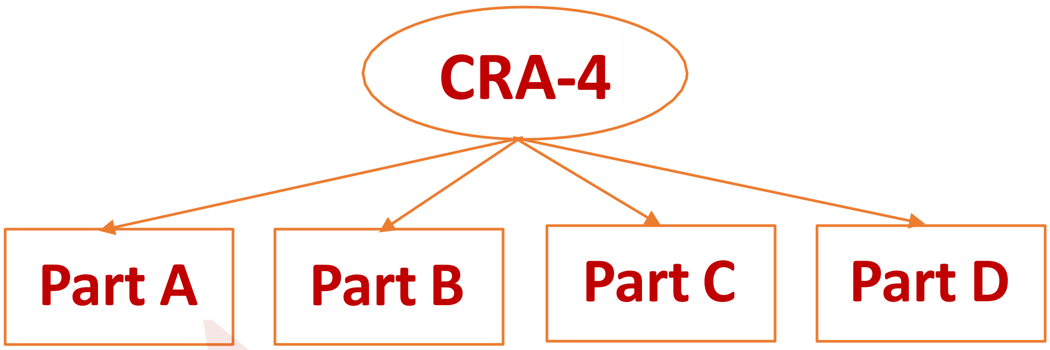
Using them to covert data in excel or other format to XBRL

Process to be followed to report in XBRL format
(1) Mapping of individual cost element with the costing taxonomy
(2) Populating data in the software / tools
(3) Creating instance document
(4) Validating the instance document in the MCA portal
(5) Checking the correctness of Data with the help of XBRL tools
(6) Attaching the instance document with the eform (CRA-4) &
(7) Filing at MCA portal

STEPS for Filing Cost Audit Report in XBRL Format in MCA portal
(1) Creation of XBRL instance document ◉ Costing data XBRL software ◉ Instance document creation using XBRL package
(2) Download XBRL validation Tool ⬇ MCA portal
(3) Load the instance Document ⬇ XBRL viewer / software
(4) Validate XBRL instance Document ⬇ whether costing taxonomy has been properly mapped with costing data
(5) Pre-Scrutiny of XBRL instance Document
(6) Convert into PDF & verify the content of instance Document
(7) Attaching of instance Document to CRA-4
(8) Submit the CRA-4 in the portal

CRA-4 is to be filled along with the reservation / explanation & attachment in XBRL format

CRA-4 is an eform which needs to be uploaded in the MCA portal along with the attachment (i.e., instance document) in XBRL Format. i.e., The whole CRA-4 is not in XBRL but only the instance document which is a part of CRA-4 in XBRL format. But without the instance document (in XBRL) the CRA-4 cannot be uploaded in MCA portal.



<u>XBRL error filling</u>

(1) <u>Common Errors</u>

- ✓ Mandatory field
- ✓ Date
- ✓ Internet
- ✓ PDF not generated
- ✓ Numeric field
- ✓ Yes / No error

(2) <u>Interpretation Errors</u>

- ✓ Costing Taxonomy not mapped properly as per XBRL rules
- ✓ Tagging of data not done as per the XBRL format
- ✓ Uses of incorrect terms

<u>Some of the interpretation errors are mentioned below:</u>

–	Table (Hypercube): - Relation between row & column
–	Axis (Dimensional): - Relation between one table with another
–	Explicit – member: - Error in costing element defined in taxonomy
–	Typed member: - Input of data by the user in the document

SPACE FOR NOTES

SPACE FOR NOTES

SPACE FOR NOTES

CHAPTER – 9 BASICS OF MANAGEMENT AUDIT

- The Management Audit is the audit of the overall management of the company rather than the performance of individual managers. The audit is conducted by an independent auditor or the employee of the company who is independent or not related to that particular management/function whose audit is being conducted.
- The auditor will critically analyse the efficiency & profitability of the management.
- There is no rules specifying the management audit i.e., it is not mandatory in nature.
- There is no qualification criteria of the management auditor.

Example:	KPMG is a company which has an IT department whose role is to manage the IT related assets of the company. The company is now conducting the audit/management of IT department.

Company how many Laptops are there → 1000

IT Salary
10 Lakh Monthly

- Storage
- Data theft
- IT controls

4 crores
Outsource → 10 Lakh
1000 per Laptop
Monthly AMC

4 crore @ 1.5%
6 Lakh

Outsource
10 Lakh
- ✓ Data Secrecy
- ✓ Time Idle

In house
10 Lakh → Salary
6 Lakh → Interest
16 Lakh

Management Audit

independent review analysis assessment

⬇

Competencies & Capabilities of overall management of the company

⬇

To understand how they are applying the strategies and resources. To check its impact on the profitability of the company.

- Effectiveness of Management
- Profitability enhancement

Overall Objective

- Decision making
- Defects & irregularities in Management
- Effective discharge of Duties & responsibilities
- Identifying process gap & strengthening
- Cost effective implementation of plans

Issues Addressed by the Management Auditor

- Appropriateness of organization structure & reporting
- Co-ordination between department
- Risk Management structure
- Stakeholder Management
- Project evaluation including growth budget & appropriate Methodology

Qualities of the Management Auditor

- Good Knowledge & experience of Managerial functions
- Knowledge of financial, cost statement & analysis technique
- Economic & Labour law knowledge
- Organisational structure knowledge
- Organisational objectives knowledge
- Policies & Procedures applied by the Management
- Production Process
- Auditor should have proper understanding of lack of coordination between department
- Auditor should give suggestion to the problems of the management

Advantage of Management Audit

- Helps in planning & policy making of Management
- Helps in achieving the objectives of the Management
- Helps in identifying the process gap/coordination gap and way to achieve or improve the performance of Management
- Helps in resource Management & improve proper utilization

Management Audit Programme (MAP)

MAP means the planning of the outlines for the whole process & procedures from beginning to end.

- Study the organisation structure
- Decision making process and line of command.
- Understanding the objective & plan with top management.
- Policies & Procedures to achieve the objectives.
- Identify the area of improvement.
- Recommend the area of improvement in the operation or decision-making.
- Adequacy & effectiveness of control of Management

Management Auditor report should include the

Areas of weakness & suggestion for improvement

Stakeholder Management

Stakeholder relationship should also be reviewed

Functions of Management Audit

- Clear identified roles to perform while dealing with top Management
- Perform review of all the areas under his scope of work
- Suggestions for improvement after evaluation

Note:	Management Audit can only be successful if the Top Management take part in the same. The "Tone at the Top" i.e., the management at the top most should help the management auditor to perform his duties effectively. If the duties of the management auditor is not performed properly the management may not have the purpose of audit achieved.

Focus areas of Management Audit

- Assessing existing Management policies
- Proper utilization of resources
- Efficiency & effectiveness of current business plan or overall objectives & strategies of Management
- Focus on overall team's function and not on individual roles & responsibilities

Top Objectives of having a Management Audit are:
• Clearly defined prime objectives
• Proper Organisational reporting structure
• Goal setting & aligned with the business activity.
• Improving effectiveness of the overall organisational process
• Suggest areas of improvement
• Effective utilization of resources
• Profitability & efficiency improvement

Management Audit can address financial questions too, like:
• The management's role in the annual budgeting exercise of the company.
• Plan /Budget deviations and reason therefor.
• Existence of function-based approval prior to Finance accord.
• The compliance level of the current policies employed by the finance team of the company.

Role of CMA in Management Audit

Qualities required for Management audit which Cost Accountant possesses
• Ability to understand business problem
• Ability to understand business processes
• Rules & Regulations → general understanding
• Applicable laws → general understanding
• Subject matter / background understanding → Science, Engineering, Statistics, Costing, Accountancy
• Professional conduct of duty / Personality as per the requirement

Management Auditor may embrace the following areas: -
• Formulating Plan & Policy
• Decision-making process
• Designing the organisation authority structure
• Measuring & evaluating business performance
• Tax Planning & budgeting

- Improving communication

Internal	There should be proper flow of communication between the department for overall improvement and working of organisational structure.

External	Further there should be follow of external communication such as laws of land / market condition / competitor knowledge / customer understanding to strengthen the overall business process.

Reliability on Data Management
1. Source of Data
2. Purpose
3. New Evidence
4. Cost is important factor
5. Validity
6. Collection process and relevancy
7. Method of improvement
8. Channel of communication & reliability

9.	Access controls & data sharing process
10.	Adequacy / accuracy / necessity of data

Management Auditor shall check whether there is cost effective utilisation of resources

- Human (Labour / work force)
- Physical
- Financial
- National (including resources available for public)

- Fluctuations in production, work-loads, and services
- Communication channels and openness in the Organisation
- Information sharing among multiple locations of the entity

There should not be any wastage and the utilization should be proper i.e., Efficiency of management to utilization each & every resource available to the company.

Execution of Principals and Policies:	It reviews whether the policies and the principles deployed by the company are effective and successful.

Management Audit Checklist

Management Audit Checklist is used to ensure that management systems and processes are effectively addressing the objectives and goals of the business/entity or company. The following template (A Specimen) can be used by compliance teams or management auditors to record and report any act of non-conformity. Few steps are given hereunder.

Administration:

- Roles and Responsibilities are assigned for administrative functions?
- Policies and Procedures are in place for monitoring activities?
- Aware of the policies and procedures?
- Management committee meetings held at intervals prescribed by the constitution?
- The annual report distributed to the members?
- Members limited to certain committee members?
- Functional reporting hierarchy is in place?
- The backup is stored in a different location w.r.t the main computer?

Finance:

- Budgetary process and approval mechanism is in place? Are all transactions recorded?
- Cash Flow Statement prepared and reviewed by senior management on regular basis?

- Financial report produced for management committee and general meetings?
- Goals are set with assigned responsibility for achievement?

Insurance:

- Whether all Company Assets across locations are covered with adequate insurance against insurable perils?
  - Whether 'loss of Profit', Earthquake, Burglary etc. are covered?
  - Does the company have insurance cover for the following?
    - Amateur accident insurance
    - Public liability insurance
    - Directors' and officers' insurance
- Whether the members aware of the insurance coverage and related policies?
- Whether Claims are made prudently as per stipulation in Policies?

Policy:

- Documented policy guideline for all critical areas of business?
- Coverage of multiple Rules and Regulations are looked into while framing Policy guidelines?
- Policies are communicated/distributed to all employees?

- Reviewed and monitored at regular intervals annually?
- Guidelines are immediately brought to notice?
- Are there policies on the following issues?
  - Harassment
  - Drugs
  - Alcohol
  - Coaching ethics
  - Child protection
  - Disabilities

Planning:

- Culture of action oriented
- The company have a strategic plan or development plan?
- Deviation against Plans are mapped and adequate
- The company have a marketing plan?
- Jobs completed in the time frame stated in the plans?
- Adequate resources to implement the plans?
- Company has an emergency evacuation plan?
- Plans reviewed annually?

Personnel Management:

- Having a Human Resource Policy in place?

- Appropriate codes of conduct?
- Practices are followed to retain resources and avoid attrition?
- Retrenchment
- Complaints available to address matters raised?

Contracts:

- Appropriate legal safeguard evaluated for any expected shortcoming or execution problems?
- Is the company involved in any of the following contracts?
  - Employment
  - Lease
  - Membership
  - Sponsorship

Hazard Identification and Control:

- HAZOP exercise carried out to protect the probable impact on mishap?
- Are work health and safety inspections carried out on the following?
  - Buildings
  - Equipment
  - Grounds
  - Parking
- Relevant authorities made on hazardous operations?

- Procedure for reporting maintenance needs?
- Risk assessments created for events?
- Procedure for reporting accidents, injuries, and incidents?

Event Management:

- Appropriate steps been taken to reduce risks?
- Risk management procedures maintained and updated?
- Documented contingency plan in place documented?
- Risk considered high priority when conducting an event?
- "Code of Behaviour" been set?

Legislation and Industry standards:

- Whether appropriate legislative and industry standards are made known to related responsibility owners?
- Whether penal actions on non-compliance also appraised to the persons accountable to ensure compliance?
- Is the company aware of the government standards?
- Whether a 'good governance' practice is circulated to ensure 'beyond compliance'?
- Whether legal experts are manned to ensure compliance issues?

Q. What are the steps of Management Audit?

(1)	Objective & scope i.e., area of operation of Management Auditor
(2)	i. Collect appropriate Documents & information gathering ii. Gap identification & mitigation (Discussion with management) iii. Issue of formal report
(3)	Result vis-a-vis Industrial standard? i. Yes ii. No → Further steps
(4)	Process to achieve Industrial standards or norms i. Planning ii. Execution iii. Performance measurement & controls
(5)	Detailed investigation → collecting all relevant Document & information / Data
(6)	Report the finding and make suggestion / recommendation

Management Audit Procedures	
(1)	Preliminary survey of activity under audit (Background analysis)
(2)	Data collection & Information gathering
(3)	Discussion regarding "Pain Point" (Problem understanding)

(4)	Analysis to accomplish audit objective (applicable laws & regulation / restriction & limitation)
(5)	Study the policies governing the activities, & identify any gaps & weaknesses
(6)	Identifying weaknesses, process gaps & discussion with Management
(7)	Report of finding & recommendation

Techniques used by management auditor to identify problem areas

1. Identification of possible control weakness by survey

- Preliminary survey work, though practical working information
- To control effectively or be susceptible to abuse.
- Points in the purchasing process may be:
  - a) The determination made of the quantities and the quality of materials to be purchased.
  - b) The procedure followed in obtaining the best prices, and
  - c) The methods for determining whether the correct quantities and quality are received.

2. Review of Management Reports (MTS reports)

- MIS (Management Information System) for various areas and Reports created and distributed for perusal by management from time to time.

3. Review of Internal Audit

- Using the outcome of other professional work
- Quality and depth of coverage.

4. Physical Inspection

- Quality of assets, usage, physical condition etc.
- Executive rework operations, or disposal of apparently useful materials or equipment.

5. Test Examination of Transactions

- Guidance being adhered to through selection
- To pursue several transactions about the organisation's operations from initiation to final disposition.

6. Discussions with officials & Employees

Review of Management System Control

- Understanding process flow
- In depth audit of particular / selected transaction
- Auditing in & around IT related things (computer)

• Policies of the organisation are proper or not
• Management control is designed on the basis of the policy designed by the top Management.
• Management control provides adequate control over the resources of company

Other factors which may be considered while auditing management system controls
• Capabilities of person
• Failures to accept responsibilities
• Duplication of effort
• Improper use of funds
• Improper use of resources
• Lack of clarity of procedures & policies framed by Top Management

Techniques of Management Audit

1. **Accounting / Economic Technique**

✓ Break-even analysis

✓ Budgetary control including a flexible budget system

✓ Discounted cash flow and net present value methods

- ✓ Cost-benefit analysis
- ✓ Standard costing and marginal costing

2. Scientific technique (Linear Programming / Transportation or Simulation)

- ✓ Computer Models
- ✓ Network Analysis
- ✓ Mathematical Analysis

3. Statistical analysis

- ✓ Monte Carlo Simulation
- ✓ Activity sampling
- ✓ Smoothing

4. Personnel technique

- ✓ Interviewing Training Survey etc.

5. General technique

- ✓ Brain storming
- ✓ Transfer pricing
- ✓ Management by objectives
- ✓ Management by exception
- ✓ Corporate planning

- ✓ Information theory

Management Audit Evidence

- Internal Source
- External Source
- Evidences are to be documented
- No particular standards hence have to completely rely on the Management Auditor's experience

Management Audit Report (MAR)

MAR is the report or the reflection of how the review was conducted by the Management Auditor.

Characteristics of good MAR

- Pertinence
- Comprehensiveness
- Brevity
- Motivating
- Data based to support outcome
- Appropriate

Content of MAR

- Exception reporting
  - Highlighting your drawbacks
- Comparative analysis
- Awareness to the management
  - Regarding the activities performed in line with objective of the company
- Logical presentation & readable
- Solution / recommendation should be highlighted

Special Report

- Report for Banks / Creditors
- Report to shareholders
- Report to employees
- Report for small business

(1) Report for Banks / Creditors

- The form and content of financial statements and schedules are important to the lender

(2) Report to shareholders

- By financial experts, bankers, tax authorities, public officials, and research people
- Correct message to a layman
- Report is often used as a public relation
- An auditor's report in the prospectus at the time of public issue is very important. Experts read "between the lines".

(3) Report to employees

- Charges by unions, or explain the need for continuance of the business in times of strike, competition.

(4) Report for small business

- Companies Act is the same for a large.
- A great deal of reporting for small businesses is subjective, due to a lack of adequate data. This poses problems in analysing and comparing data. Suggestions in the report must be based on a proper appraisal of the problem.

SPACE FOR NOTES

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CHAPTER – 10 Management Reporting Issues & Analysis

Various types of Management Audit Reports	
(1)	**Based on characteristics** ☞ Financial Report • Cash Flow report • Cost of Borrowing • Budgetary Analysis • Comparative analysis of financials ☞ Information Report • Trend Report • Analytical Report • Activity ☞ Control Report
(2)	**Based on Nature** ☞ Enterprise • Prepared for Banks / FI / SH / Government authority ☞ Investigative

	• To investigate certain problem
(3)	**Based on Function** ☞ Joint Activity Report ☞ Individual Activity Report

Performance Analysis	
(1)	Parameters • Past • Current
(2)	Actual performance
(3)	Micro/Macro
(4)	Root cause analysis
(5)	Feedback from Employees → Business performance
(6)	Review of Past performance
(7)	Comparative analysis of performance
(8)	Management decision analysis

Types of Analysis

- Capacity Utilization Analysis
- Productivity & Efficiency Analysis
- Utility & Energy Efficiency Analysis
- Key Cost & Contribution Analysis
- Profitability Analysis
- Working Capital & Liquidity Management Analysis
- Manpower Analysis
- Other areas

Capacity Utilization Analysis

Example:	A machine can manufacture 100 units. But the machine manufactured 70 units only in F.Y. 21-22 Capacity Utilization $= \frac{\textbf{70 (Actual output)}}{\textbf{Maximum output 100}}$ **x 100** = 70%

Capacity Utilization $= \dfrac{\textit{Actual output}}{\textit{Maximum output}} \times 100$

High | **Low**

Excess / Surplus / Under utilization

Demand – 60	Production – 70	Maximum – 100
Surplus		

Demand – 120	Production – 70	Maximum – 100
Underutilization and Excess demand		

Company Machine: 2,00,000 → 100 units

$\underbrace{2000 \times 20 = 40{,}000}_{\text{Opportunity Cost Loss}}$ → 80 units

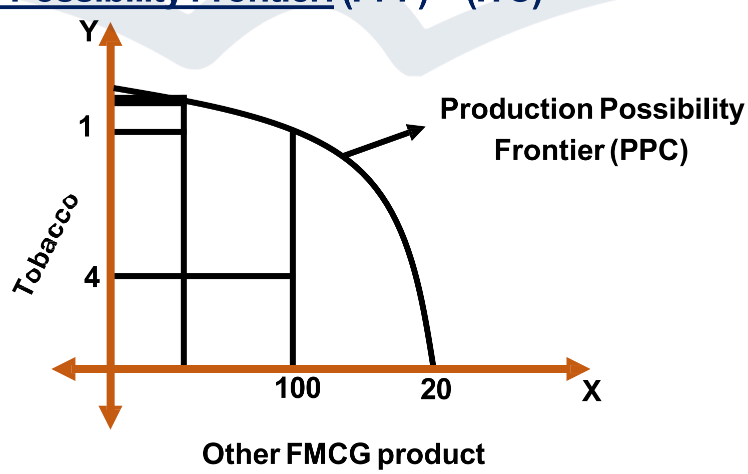
Economic Significance of Capacity Utilization

Excess

Surplus

Under utilization

(2) Productivity & Efficiency Analysis

Notes:	
(i)	**Productive Efficiency:** It refers to the efficiency of the company to produce the maximum level of output by using the limited amount of resources Here different company may fight for a limited or scarce resource for example → Crude oil, Petroleum, Semi-conductor chips etc.
(ii)	**Productive Possibility Frontier: (PPF) →(ITC)** 

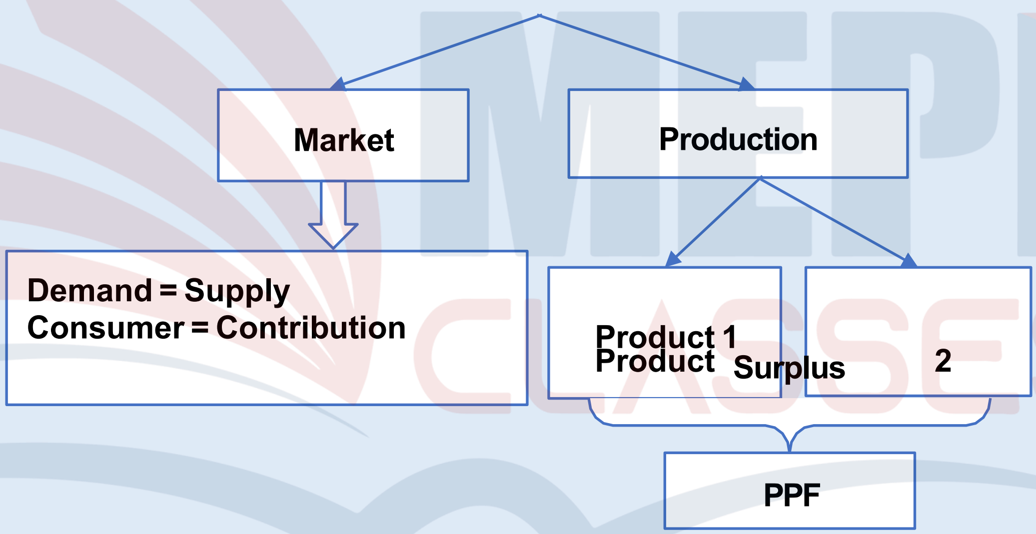
Using the same input resources for Manufacturing both the product

- It is the frontier or a curve which gives a comparative analysis of products (two) manufactured by the company using the inputs available with the company.

- Increase in production of 1 product (i.e., Product x) will lead to decrease in production of (Product Y) as the resources are scarce in nature.

(iii)

Allocative Efficiency:



- Proper allocation of goods & services in the market
- The benefit of the consumer buying the goods & services = Marginal Cost of production of each unit

  Ex: 10 products = ₹ 1000
  11 products = ₹ 1200 } 200 ↑ **Consumer benefit**

- The concept of Marginal Cost =

$$\frac{\Delta \text{ Cost of Production}}{\Delta \text{ Quantity}} = MC$$

- Consumer Surplus: Price a consumer is willing to pay to buy an additional commodity

  Marginal COP = Consumer Surplus

Thus, the company will never incur loss as the product is providing the surplus to the consumer which is equal to the marginal cost of production.

(3) Utility & Energy Efficiency Analysis

- There should be proper utilization of Energy (Power/Electricity) towards sustainable development of the world.
- There should be sustainable Energy Policy.
- Factories/Manufacturers can use green Energy i.e., Energy produced from Bio gas, windmill, etc. (Renewable Energy).
- Less Energy consumed to produce more products.
- India → Commercial Truck → BS 6 → Pollution

  BS 4 → 10 years

  BS 5 → 15 years

  India (Bharat) is telling the people to scrap the vehicle which is older than 10 years.

- Cogeneration System: The process of trapping the heat generated by the industry & using it for the purpose of heating/cooling in various other industry.

- Recycling: The use of product generated in the production process which can be reused for further production or can be recycled by another industry. Example: Aluminium, Glass, Water, Solar cells, Paper etc.

Barriers to Success

- High initial investment
- Lack of understanding & clarity of Benefits
- Less concerned over Environmental impact
- Mentality (Old is Gold)

Ex: Use of Solar Energy instead of normal electricity

(4) Key Cost & Contribution Analysis

Contribution per unit = $\frac{Total\ Revenue - Variable\ Cost}{No.of\ units\ sold}$

Total Revenue ↑ Variable ↓
Contribution ↑
↓
Overall Profitability ↑

Example:

Total Revenue: 10000/-

Total cost of product: 8000/-

Unit sold: 200

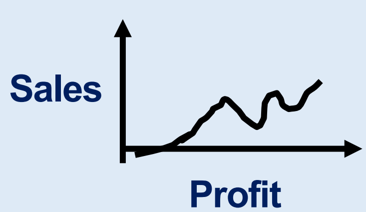
Contribution/unit: $\frac{10000-8000}{200}$ =10/-

Total =2000/-

Break Even point = Fixed cost = Contribution

Profit Volume chart:

It is a graphical representation of volume vis-a-vis profit



If there is 10% increase in sales, will it lead to 10% increase in contribution

↑ 10% TR - TVC (10% more) =Contribution ↑ 8%

Advantages	**Disadvantages**
✓ Decision Making	✓ Assumptions not taken correctly
✓ By having unit wise contribution & Break Even → Performance can improve	✓ Unrealistic figures can lead to false analysis
✓ Helps in understanding critical points i.e., Revenue & Contribution mismatch	

(5) Profitability Analysis

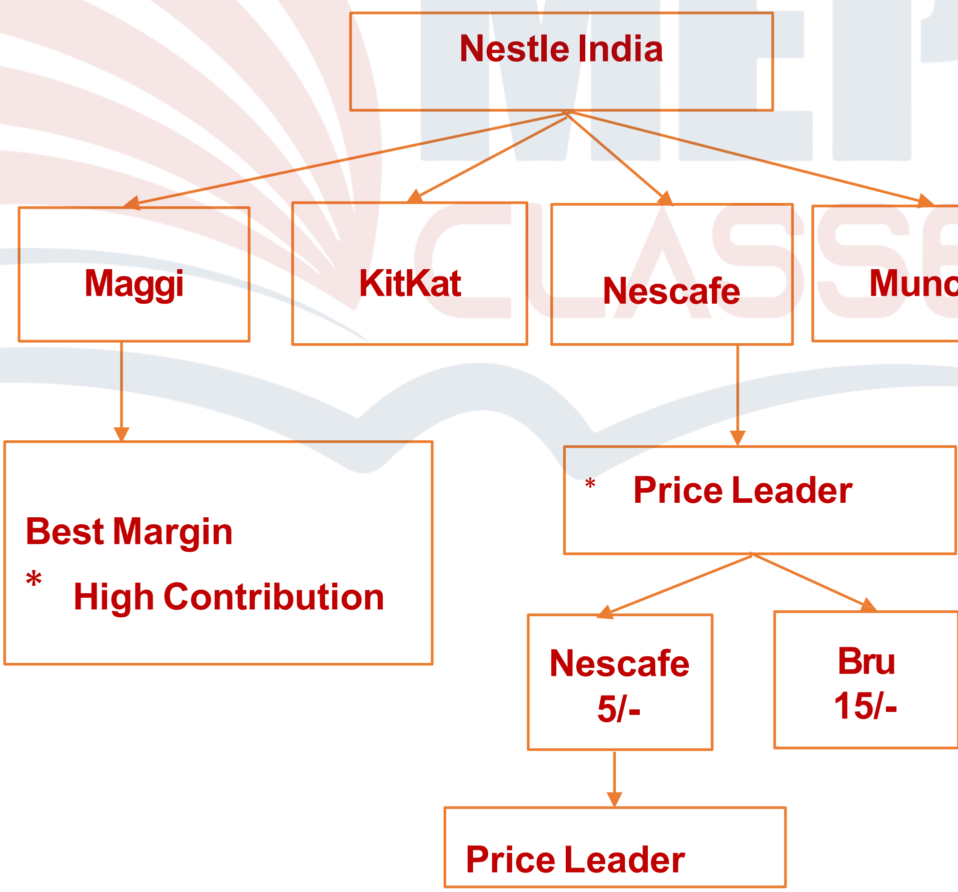
Contribution: TR – TVC

Contribution - FC - OC - Debenture - Interest - Tax = **Profit** → **Sustainable**

Budgeting → Profitability should be considered

Types of Profitability Analysis	
(1)	Ratio Analysis ✓ Return on Equity (ROE) ✓ Return on Asset (ROA) ✓ P/E Ratio ✓ EPS

	✓ EBIT/EBDIT
(2)	Customer wise profitability Analysis ✓ Customer Centric ✓ Favourable customer gives good margin
(3)	Qualitative Analysis ✓ Charts ✓ Technical analysis ✓ Business cycles
(4)	Product Profitability Management Example →



1) Each product performance (Market)
2) Contribution of each product
3) Profitability → Product wise
4) Price Leadership
5) Regulate Pricing policies

(5) Product wise costing Analysis

Important Ratio

Sales to Stock Ratio

$$= \frac{Net\ Sales}{Average\ Inventory}$$

Gross Margin

$$= \frac{Gross\ Profit}{Net\ Sales}$$

Example:	
Net Sales = 1000 Average Inventory = 500 $\therefore \frac{1000}{500} = 2$	Gross Profit = 10000 Net Sales = 5,00,000 $\therefore \frac{10000}{500000} = 0.02$

.

(6) Working Capital & Liquidity Management Analysis

Objective of Working Capital Management

- Liquidity for operation of Business
- Financial obligation fulfilment
  - ✓ Creditor's payment
  - ✓ Payment of wages etc.

Benefit of Working Capital Management

- To check on the Current Asset Levels
- To check on cash generation of the company
- If working capital not managed properly it may lead to corporate collapse

Working Capital: Current Assets - Current Liabilities

- Current Assets → CA + Cash & Other Liquid (Sundry Debtors)
- Current Liabilities → CL + Bank O/D utilized + short term loans

Over Trading
(Under Capitalization)
Credit Sales: 200 cr
Liquid: 0
200 cr Working Capital

Short term loan Long term loan	Which may lead to interest payment

[Less Working Capital but more Sales]

Over Capitalization

O/D: 500 cr
Term loan: 500 cr
↓
INCOME
Monthly EMI: 10 cr
Sales: 500 cr

[More Working Capital but less Sales]

Types of Ratios

(1) Liquidity Ratio

Current Ratio = $\frac{Current\ Asset}{Current\ Liability}$

Acid Test Ratio (Quick Ratio) = $\frac{Quick\ Asset}{Current\ Liability}$

$= \frac{CA - Inventory}{Current\ Liability}$

(Slow moving inventory)

(2)Efficiency Ratio

a) Inventory T.O = $\frac{\textit{Cost of Sales}}{\textit{Average Inventory}}$

b) Inventory Days = $\frac{\textit{Average Inventory}}{\textit{Cost of Sales}} \times 365$

- Raw Material days = $\frac{\textit{Raw Material}}{\textit{Cost of Sales}}$
- Work-in-Progress days = $\frac{\textit{Work in Progress}}{\textit{Cost of Sales}}$
- Finished Goods days = $\frac{\textit{Finished Goods}}{\textit{Cost of Sales}}$

c) Trade Payable Days = $\frac{\textit{Average Trade Payable}}{\textit{Annual Credit Purchase}} \times 365$

d) Trade Receivable Days = $\frac{\textit{Trade Receivable}}{\textit{Credit Sales}} \times 365$

e) Sales to Working Capital = $\frac{\textit{Sales}}{\textit{Working Capital}}$

(3)Cash Operating Cycle

(Working Capital Cycle/Conversion Cycle)

= Inventory Days + Receivable Days – Payable Days

Higher the operating cycle than higher the requirement of working capital

Nature of Business

- ✓ Credit Sales
- ✓ Cash Purchase
- ✓ Inventory Required

Industry Norms

- ✓ Credit Sales
- ✓ Industry norms in all sector require Credit Sales
- ✓ Ex: Transport, Textile

Power of Suppliers

Printing Suppliers they offer huge credit days

Example:

Topple Co has the following forecast figures for its first year of trading:

Sales ₹ 36,00,000

Purchases expense ₹ 30,00,000

Average receivables ₹ 3,06,000

Average inventory ₹ 4,95,000

Average payables ₹ 2,30,000

Average overdraft ₹ 5,00,000

Gross profit margin 25%

Industry average data: Inventory days 53

Receivables days 23

Payables days 47

Current ratio 1.43

Assume there are 365 days in the year.

Required:

Calculate and comment on Topple Co's cash operating cycle, current ratio, quick ratio, and sales to working capital ratio.

Solution:

(1) Inventory Days = $\frac{495000}{27,00,000}$ $\mathbf{x\ 365}$ = 67

(2) Receivable Days = $\frac{306000}{36,00,000}$ $\mathbf{x\ 365}$ = 31

(3) Payable Days = $\frac{230000}{30,00,000}$ $\mathbf{x\ 365}$ = 28

(4) Working Capital Days (Cash Operating Cycle)

= 1 + 2 – 3

= 67 + 31 – 28 = 70

(5) Current Ratio: $\frac{CA}{CL} = \frac{495000 + 306000}{230000 + 500000} = \frac{801}{730} = \mathbf{1.10}$

(6) Quick Ratio: $\frac{CA - Inventory}{CL} = \frac{306}{730} = \mathbf{0.42}$

(7) Sales to WC: $\frac{Sales}{CA-CL} = \frac{3600000}{495000+306000-230000-500000}$

=51 times

(Overdraft is long term loan)

$=\frac{3600000}{495000+306000-230000} = 6.3\ times$

Industry Standards	
Inventory days → 53	Current Ratio
Receivables days → 23	1.43
Payables days → (47)	In our case CR is 1.10 which is below the industry standard hence we should try to increase the same to the industry standards
Cash operating cycle 29 days	
Here, in our case the cash operating cycle is above the industry average by 70 – 29 = 41 days that means more of our capital will be stuck in working capital	

Sales to Working Capital	$=\frac{Sales}{CA-CL\ (Excluding\ Overdraft)}$
Working Capital	=100
Sales	=100 x 6.3
	=630

(7) Manpower Analysis

(A)

Manpower Management:

The need of the organisation of skilled/unskilled workforce for completion of the objective efficiency & productivity is achieved is called manpower management.

(B)

Manpower Dimension:

- Total no. of employees Power available
- Job description
- Attributes → Age, Qualification, Experience
- Man Needs

(C)

Manpower Management Objectives:

- Availability of Human Resources
- Replacement cost Reduction
- Employees Moral & Satisfaction improvement
- Monitor retrenchment & retention policy
- Focus on Training

(D)

Job analysis →

Manpower estimation also consider Job analysis for proper Manpower analysis

Job Description

Job Specification

Job Evaluation

(E)

Manpower Inventories:

No of Employees

Classification of Characteristics

- ✓ **Classification based on skill**
- ✓ **Classification based on Job Description**

Steps to measure Manpower inventory

Who shall form the part of inventory
↓
Person to be included

Collection of Information
- ✓ Age
- ✓ Description
- ✓ Knowledge

To appraise the Manpower
↓
- ✓ Training
- ✓ Test
- ✓ GD/PD

Example:

Suppose RIL want to start a new Line of business so he will prepare a manpower inventory which is required for the new business

Identify the executives from Existing Business

Collecting information
↓
If from information collected Manpower not sufficient
↓
Recruit more

Appraisal

Train them for new line of Business

We will have right labour at right time for Efficient handling of business

Strategies for Manpower Planning
• Collection of information regarding Human Resources
• Periodical Review
• Development of procedures to determine manpower requirement
• Technique for allocation of work
• Measures for utilization of Manpower
• Procurement Policy
• Process of Appraisal such as Training etc.
• Process of Management to improve Employees performance

Activities for Manpower Planning

- **Forecasting** ⇩ **Future Manpower Requirement**
- **Manpower inventory** ⇩ **To check the optimality of the current Manpower of Company**
- **Anticipation of problem**
- **Planning of Selection, Training, Development** ⇩ **To ensure adequate manpower supply in future**

Steps for Manpower Planning

- Anticipating Requirement
- Job description planning
- Skill requirement
- Selection of resources or adequate resource recruitment

Human Resource Planning	
(1)	Demand Forecasting
(2)	Supply Forecasting
(3)	Future Deficit → Recruitment (Increase Manpower)
(4)	Plan for Recruitment
(5)	Future Surplus → Retrenchment (Decrease Manpower)
(6)	Plan to modify or adjust the organisation plan on manpower management
(7)	Manpower Materiality → Calculation of net Manpower resource available

- **Short term (1 year)** ⬇ ≤ 1 year
- **Long term (10 year)** ⬇ 15 years, 6–15 years
- **Middle term (5 year)** ⬇ <u>Generally</u> 1–5 years

STEPS OF MANPOWER ANALYSIS

- Analysis of objective of org about human resources planning
- Forecasting future human resources requirement (manpower requirement)
- Forecasting Supply of Manpower
  - a) Manpower Inventory
  - b) Manpower Audit
  - c) Job Evaluation
- Comparing Demand Forecast & Supply Forecast
- Preparing Plans & Programme
- Execution of Plan & Programme and Evaluation of Manpower Planning

Manpower Planning Process

The process of manpower planning works in a stepwise manner. The steps for the same are –

- Need identification: Each department has to identify its targets and get resources allocated accordingly.
- Succession plan: Then, a succession plan must be formulated by the personnel managers of each department ensuring that they

incorporate additional training programs to alleviate the labour turnover rate of the company.

- Planning: Planning is done for recruiting candidates if there is a shortage of staff in the organisation.
- Redundancy plan: A redundancy plan must also be developed in case the organisation feels that there are employees in a company not required due to lack of adequate knowledge to handle the job/perform.
- Approval: These plans and proposals made by the personnel managers are then sent to the higher management team for approval. If these are approved, then each department seeks to implement them, and depending on the needs of individual departments and cost constraints, these plans are evaluated and managed

Techniques Used to Determine the Requirements of Personnel:

The four methods generally used to determine the requirements of personnel are

- Annual estimate of vacancies;
- Long-range estimates of vacancies;
- Fixed minimum manpower specification-wise requirements; and
- Specific position estimations.

Approach to HR Demand Forecasting:

Quantitative	Qualitative
Forecasting by use of statistical / mathematical technique	Forecasting based on less quantitative approach
Trend Analysis	We reconcile the interest, abilities, aspiration
❖ Select an appropriate business factor. ❖ Historical trend of the selected Business factor about HR requirement. ❖ Compare productivity ratio of the past 5 years.	Future HR requirement of the organisation

HR planners many times go further and analyse the demand based on the following:

I. Workforce analysis to determine the rate of influx and outflow of employees – It is through this analysis one can calculate the labour turnover rate, absenteeism rate, etc. Qualitative methods go a long way in analysing the internal flow created by promotions, transfers, etc.

II. Workload analysis, with which one can calculate the numbers of persons required for various jobs concerning a planned output – This takes into consideration factors such as absenteeism, idle time, etc. Both quantitative and qualitative techniques are utilised for accurate results.

III. Job analysis: Job analysis helps in finding out the abilities or skills required to do the jobs efficiently. A detailed study of jobs is usually made to identify the qualifications and experience required for them. Job analysis includes two things – job description and job specification. Job description, thus, is a factual statement of the duties and responsibilities of a specific job. It indicates what is to be done, how it is to be done, and why it is to be done. Job specification provides information on the human attributes in terms of education, skills, aptitudes, and experience necessary to perform a job effectively.

Supply Forecasting Techniques

↓

Sources of Manpower Supply

- **Internal Sources – Using the internal strength of the organization**
  ↓
  - Analysis of Retention
  - Stability Index
  - Cohort Analysis
  - Census Method
- **external Sources – Recruitment of Employees from outside**

Labour Turnover =

(No. of Levers in the year / Avg no. of Employees in a year) x 100

Example –

100 Levers

1000 Employees

(100/1000) x 100 = 10%

Stability Index =

(Employees in service for at least 1 year / total no. of employees) x 100

Example –

100 Levers

1000 Employees

500 Employees worked for at least 1 year

(500 / 1000) x 100 = 50%

Labour Turnover = (100/1000) x 100 = 10%

Cohort Analysis

Homogenous group of Employees joined the organization during a fixed period

2020-21: Cohort Analysis

CA – 40

CMA – 50

CS – 10

Total = 100

Homogenous –

- CA – need to do more recruitment
- CMA – need to do more recruitment

Census Method

Behavior Analysis

Labour Force

- Levers – Chart – why they left the organization
- Joiners – Chart – why they joined

Determining Manpower Gaps:

⬇

The final stage is to balance out the demand and supply gap. The closer the gap the better it isfor the company when it goes into recruiting.

Acomparison chart can be developed to find what is available and to what extent it can fulfill the demand forecast. This exercise helps us have an idea of the quantitative and qualitative gaps in the workforce. Areconciliation of demand and supply forecasts will give us the number of people to be recruited or made redundant as the case may be. This forms the basis for preparing the manpower plan.

In this process, a company always needs to keep repeating this step as it operates in a changing environment. Changes in product mix, union agreements, and competitive action are some of the important things that need special attention.

The human resource requirements thus identified are translated into a concrete manpower plan, backed up by detailed policies, and other human resources instruments and strategies (for example, recruitment, selection, training, promotion, retirement, replacement, etc.).

Manpower Gap Determination:

⬇

Understanding the gap in the Demand & Supply of Manpower

Operational Plans to be considered for Manpower Planning –

- Recruitment Plan
- Redundancy Plan .
- Training Plan
- Productivity Plan
- Retention Plan
- Check / View points

The manpower plan is further divided into the following resultant operational plans:

1. Recruitment plan to show how many and what type of people are required and when they are needed;

2. Redeployment plan to help chart out the future movement in terms of training and transfers.

3. Redundancy plan will indicate who is redundant, when and where; the plans for retraining, where this is possible; and plans for a golden handshake, retrenchment, lay-off, etc.

4. Training plan to chart out if training is required. If yes, when and to which level; whether it will be done inhouse, done in phases, or included as part

of a formal induction program. This includes the cost and benefits analysis of all the options available.

5. Productivity plan will indicate reasons for employee productivity or reducing employees' costs through work simplification studies, mechanization, productivity bargaining, incentives, profit-sharing schemes, job redesign, upskilling etc.

6. Retention plan will indicate reasons for employee turnover and show strategies to avoid wastage through compensation policies, changes in work requirements, and improvement in working conditions.

7. Check/reviews points. The success of the entire exercise is dependent upon frequent reviews so that none of the factors are left out and changes are constantly taken care of. The important thing is to demarcate points for periodical checks to incorporate deficiencies and periodic updating of manpower inventory based on training and performance reviews, in the light of changing circumstances.

Need for Strategic Manpower Planning:

- Predicting Manpower needs is crucial
- Economics of Manpower Planning is also crucial
- Economics of Demand & Supply forecasting
- Get up the right people

Manpower Planning Framework

- Model of Manpower Planning.
- Function in an organization develop over time.
- Peter's Principle – Change in Competencies is governed by Peter's principle.

Models of Manpower Planning:

The models of manpower planning deal on a high level of abstraction with employee movements from function to function throughout the organisation. As a consequence, functions, and employees are seen as numbers with no characteristics.

Functions in an Organisation Develop Over Time:

- Within the organisation, the requirements of functions develop over time. As a result, employees are needed with different competencies. To decrease the level of abstraction we must avoid the pitfall of implementing too much behaviour of employees. It is not possible to model the many interactions and career patterns of employees and the occupation of function in a very detailed manner.

- The modelling of "soft" factors such as preference, or dislike of specific functions by employees is, therefore, saved for later research. Our approach is to first cover the "hard" factors of employee characteristics and function requirements, for example, education, age, and experience based on earlier fulfilled functions. To model, verify, and explain these interactions patterns that will occur over time is the first aim.

Change in Competencies is Governed by Peter's Principle:

- The competencies of the employees, which are useful for the organisation, can also decrease by several causes. In the first place, after reorganization, a shift in the competency demand of the organisation arises. The number of employees stays the same, but the amount of competencies of the employees, which are still valid for the organisation can decrease .
- As these competencies are no longer necessary for the organisation, they are not taken into account anymore. Secondly, the employee's competencies get out of date after some time`
- Fighting obsolescence is a joint responsibility of the employee and the organisation. Solutions can be to take courses or to change position in the organisation to gain new experience.
- The factors mentioned here do not change the quantity of the employees, but just the set of available competencies. Besides the mentioned processes, three other factors have an influence on the available competencies in an organisation – inflow, outflow, and absence. The inflow of employees creates growth in competencies available for the organization.
- The other two factors decrease the competencies. Insight into the trends of absence (through illness, vacation, and other causes), inflow, and outflow

can be gained by analysing historical data and by looking at the developments in the labour market

- These three factors change the obtainable competencies in the organisation by changing the number of employees within the organisation. Of course, there is a difference between inflow in the 'lowest' functions in the organisation and horizontal inflow in higher functions.

- However, at the macro level, the competencies, whether regarding existing or new employees, are governed by Peter Principle which articulates – "In time, every post tends to be occupied by an employee who is incompetent to carry out his duties" and adds that "work is accomplished by those employees who have not yet reached their level of incompetence".

Approach for developing Manpower Planning

Planning for Status Quo • Plan succession
Thumb Rule • Productivity viz Manpower
Markov Analysis (MA) • Technique – Probability distribution & Equilibrium used for forecasting a) Death, Resign, Dismiss, Incompetent
Unit forecasting

Ratio/Trend Analysis
Delphi Method
Computer Simulation
Time & Motion Study
Most-Maynard Operation Sequence Technique • Time required to complete a particular work a) Measure work

Advantages of Manpower Planning:

Besides this, the following points also throw light on the advantages and manpower planning:

1. Manpower planning involves forecasting manpower requirements in an organisation and helps the management in anticipating personnel shortages and surpluses and also to develop ways to avoid or correct problems before they become serious. Further, forecasting long-range manpower requirements help forecast the compensation costs involved in that connection.

2. A proper and systematic forecasting of human resource requirements helps an organisation to determine proper sources and methods of recruitment. Further, an organisation can also adopt a proper selection

procedure depending upon the needs of the jobs. Proper tests can be designed to select the right candidates for the right jobs. Thus, the importance of manpower planning is immense in recruiting and selecting personnel.

3. From the viewpoint of training and development, the importance of manpower planning is great. Manpower planning ensures the training of employees in an organisation. Training involves imparting knowledge and developing attitudes, skills, social behaviour, etc., of the employees. Manpower planning identifies the training needs of the personnel of an organisation beforehand so that necessary arrangements and training programs can be chalked out accordingly to give training to the employees. Training helps the organisation to utilise its human resources to the optimum. Manpower planning is not only important from the viewpoint of an organisation but it also helps the employees of an organisation in developing and in the application of skills, abilities, knowledge which affect their capacity positively as for as efficiency, earnings, etc., are concerned.

4. So far as performance appraisal is concerned, manpower planning plays an important role in that area too. Performance appraisal refers to the identification of strengths and weaknesses of the employees of an organisation relating to their jobs. It is conducted to know whether the existing human resources possess the necessary qualities and qualifications as per the requirements of the jobs. Manpower planning makes available necessary strategies to correct the weaknesses of the employees by making the proper arrangements for corrective training, retraining, and orientation programmes. All these are interrelated activities.

5. Importance of manpower planning is none-the-less in respect of controlling the labour costs. Efforts are made in manpower planning to assure the timely and sufficient supply of labour, thus, avoiding the shortages and surpluses of labour which leads to saving and controlling labour costs.

6. Manpower planning facilitates the career development of employees. Career development refers to the upward movement of the personnel employed in an organisation. Taking into consideration the long-range plans of the organisation, a career path of an employee can be projected along with what is expected from him in terms of competence levels. The employees can then plan their careers accordingly within the organisation. The clarity plays a significant role in enhancing the levels of motivation of employees – a very important role of Manpower Planning.

7. Manpower planning if done properly and systematically, problems of low productivity, absenteeism, interdepartmental conflicts, resistance to change, etc., can be tackled and solved efficiently. The effort leads to higher productivity and efficiency levels, thus stressing the importance of this major function under HR organisation. Thus, it can be said that manpower analysis helps to increase the prospects of an organisation in managing its resources in a better way and coping more effectively with dynamic situations.

Itemized income from different product lines, regions, or product types

- Return on sales and return on investment.

- Profit per employee and sales per employee.
- Financial ratios between assets, liabilities and net worth.
- Company goals over the next three, five, and 10 years.
- Market share and status.
- Reviewing and adjusting costs or spending regularly, etc.

Here are the steps to conduct performance analysis for an entire department or organisation

Variance analysis: Variance is the difference between the projected and the actual performance

Research variances: Finding the 'root cause' for the variance leads to corrective actions to preempt possibility of future expectation gap.

Analyse metrics: Understanding non-financial key business metrics can be a helpful tool in researching the causes of variances.

Decide on changes: Gaps noticed post analysis of performance, scope for improvement need to be explored. Possibility of multiple alternatives for the same shortcoming also can't be ruled out. Hence, zeroing on the best option for optimum benefits and implementation of the same is the main motto of performance review.

Review competitor performance: Data need to be collected from authentic market sources about performance of the competition. Strength, Weakness, Opportunity, Threat (SWOT) analysis to be carried out to understand strength of own brand vis- avis others, price effect, entering into new geography etc.

Typical managerial accounting tools are

Break-even analysis: The break-even point is the point at which total cost and total revenue are equal, meaning there is no loss or gain.
Capital budgeting analysis: an examination of proposals for acquiring fixed assets and related fund allocation with avenue of financing.
Constraint analysis: a tool that examines the primary bottlenecks of a business and how these affect revenues and profits.
Inventory analysis: useful for calculating cost of goods sold as well as placing a value on raw materials and unsold products.
Margin analysis: a profit analysis typically built around revenue generated by a specific subset of data, such as customer, region, product, or business branch.
Transaction analysis: tools that look at specific transactions, such as sales to a particular customer or purchase of certain goods.
Trend analysis: tools that look at changes to data over time to permit examination of changes to business conditions, helpful for creating forecasts

The various tools used at present in management accounting may be classified into the following groups.

Based on Financial Accounting Information	Based on Cost Accounting Information	Based on Mathematics	Based on Future Information	Miscellaneous Tools
Analysis of Financial Statements through Ratio Analysis.	Marginal costing (including cost volume profit analysis)	Operations Research.	Budget and Budgeting.	Managerial Reporting.
Analysis of Financial Statements through comparative statements, trends, graphs, and diagrams.	Direct or incremental Costing and differential costing.	Linear Programming.	Budgetary Control: Analysis of Budget Variance / Revenue Variance	Integrated Auditing.
Fund flow and cash flow analysis.	Standard Costing	Network analysis.	Business Forecasting	Financial Planning.

Return on capital employed techniques.	Analysis of Cost Variances.	Queuing theory and Games Theory.	Project Appraisal or Evaluation	Revaluation Accounting.
		Simulation Theory.		Decision-making Accounting.
				Management Information System

Important tools and techniques used in management accounting

- Financial Planning
- Financial Statement Analysis
- Cost Accounting
- Fund Flow Analysis
- Cash Flow Analysis

- Standard Costing
- Marginal Costing
- Budgetary Control
- Revaluation Accounting
- Decision-Making Accounting
- Management Information System
- Statistical Techniques
- Management Reporting
- Historical Cost Accounting
- Ratio Analysis

Illustration 1 –

A Company introduced a new product EZY with advanced technology in a product market where there is huge competition with many competitors having an individual market share of 5% to 10%. A survey of the present market estimates that demand will increase by 80,000 units per year. The company is presently targeting 50% of the additional market demand as competitors will need at least two years to match its product The Product EZY passes through three departments. Direct cost per unit of product at a present rate: Material cost ₹65 and Labour Cost ₹45. Overheads are absorbed based on normal capacity. The following relevant information is given:

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

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

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

Illustration 2 –

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

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

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

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

Variable Selling and Distribution Cost is ₹3 lakh for 2000 units. Expected return on investment 24%.

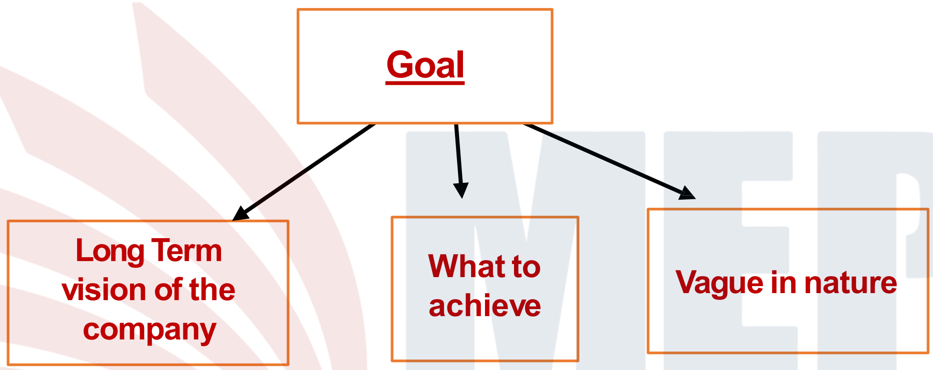
Suggest pricing of a new product for a new one or the existing ones at 80% capacity.

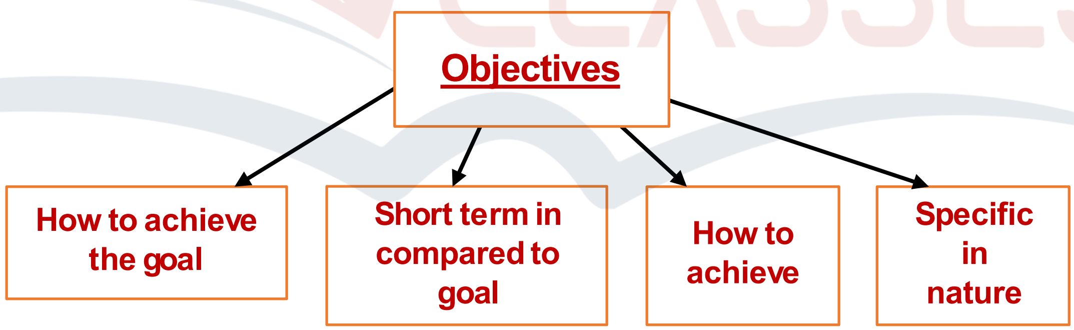
SPACE FOR NOTES

SPACE FOR NOTES

SPACE FOR NOTES

Chapter 11 – Management Audit in Different Functions





A Corporate or Business Objective is a result that a company aims to achieve. It also includes the strategies that people will use to reach there. A business objective usually includes a time frame and lists the resources available to fulfil the objective.

Business Objective vs. Goal:

A. Business goals and objectives are not the same. The goal includes a broad primary outcome. A business objective, on the other hand, is a measurable step people take to achieve that goal. Goals are general while objectives are specific.

B. A company's business objectives provide steps a picture of how it plans to achieve its goal with timeframe and resource requirement. It also states how long it will take, and what resources are available. A business goal is vague in comparison

C. People commonly use the terms 'goals' and 'objectives' interchangeably. However, they are not the same. Business objectives and goals have important differentiating attributes which we use at different stages of the planning process.

Objectives are Specific, Not Goals:

Goals are statement a business makes regarding its future. They represent the aspirations its leaders have. The CEO of a company may say: "We seek to become the largest maker of bicycles in the world." This is a goal because the person does not explain how the company will achieve this

The exact steps a company plans to take to reach its goals or aims are its business objectives. When expressing the objectives, the CEO might say –

"We will increase our sales of bicycles by 2.5% each quarter of this year. We will open new branches and factories in Hyderabad and Visakhapatnam during the next twelve months."

Business Objectives Small Companies	The main objectives of a small or very young business might be 1. Profit Maximization 2. Survival 3. Growth

When a Business Objective Clashes

- Sometimes, one business objective can clash with another, e.g. good governance with profiteering. For example, certain unethical practices endorsed by management (e.g. low quality, adulterated product) to earn additional profit at the cost of Customer satisfaction.
- Long-term objectives can affect the short-term prospects of a business e.g. high investment in new plant, equipment, or new products, will hit cash flow in the short term.

Organisational Culture –

Value nurtured by the promoters, management & employees
Differs from organization to organization
1. Nature & Human Behaviour
2. Legacy & Departure therefrom
3. Organization relationship to its environment • Appropriate Emotions • Effectiveness

Factors that shape organizational culture

- Values
- Degree of Hierarchy
- Degree of Promptness & urgency
- People Orientation or Task Orientation
- Function Orientation
- Sub-culture

Sustaining a Culture -

The management of organisational culture starts with identifying a company's organisational culture traits or "artifacts." Artifacts are the core business activities, processes, and philosophies that characterize how an organisation does its day-to-day business. Identifying these traits and assessing their importance in light of current business objectives is a way to start managing culture.

- Identify common artifacts or traits, including those from the standpoint of an organisation's social, material and ideological culture.
- Convene groups of employee's representatives from all levels, functions, and locations of the organisation-to assess the validity, significance, and currency of key artifacts.
- Subject those traits to a rigorous assessment of their underlying shared assumptions, values, and beliefs
- Summarize findings and share them with all participants to solicit additional insights
- Create a culture management action plan. The plan should enhance traits that support corporate growth or organisational effectiveness and correct traits that might hinder a company's advancement

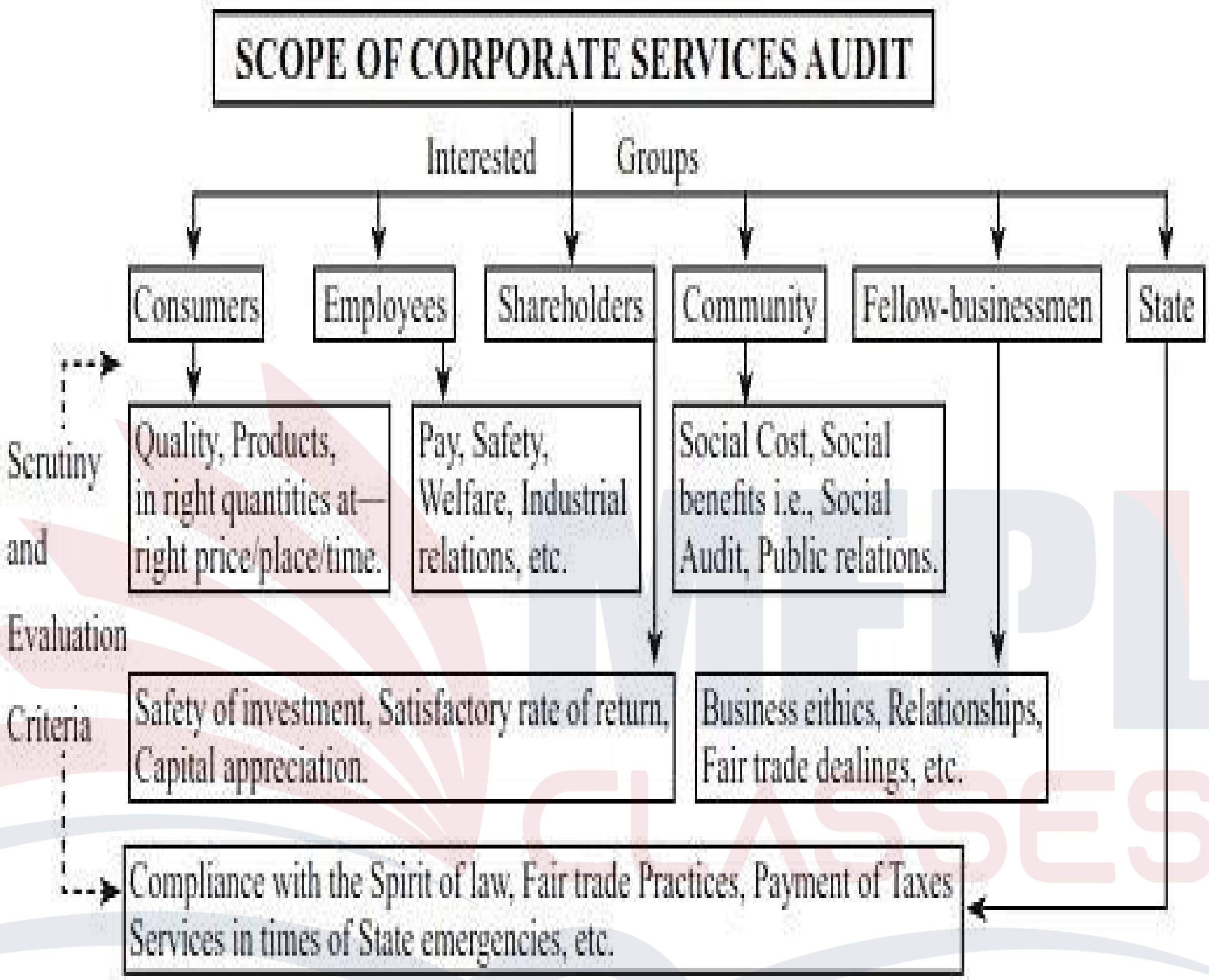
FUNCTION AUDIT	• Corporate Service Audit • Corporate Development Audit • Evaluation of Personal Development • Consumer Service Audit • Audit of Env Pollution Control

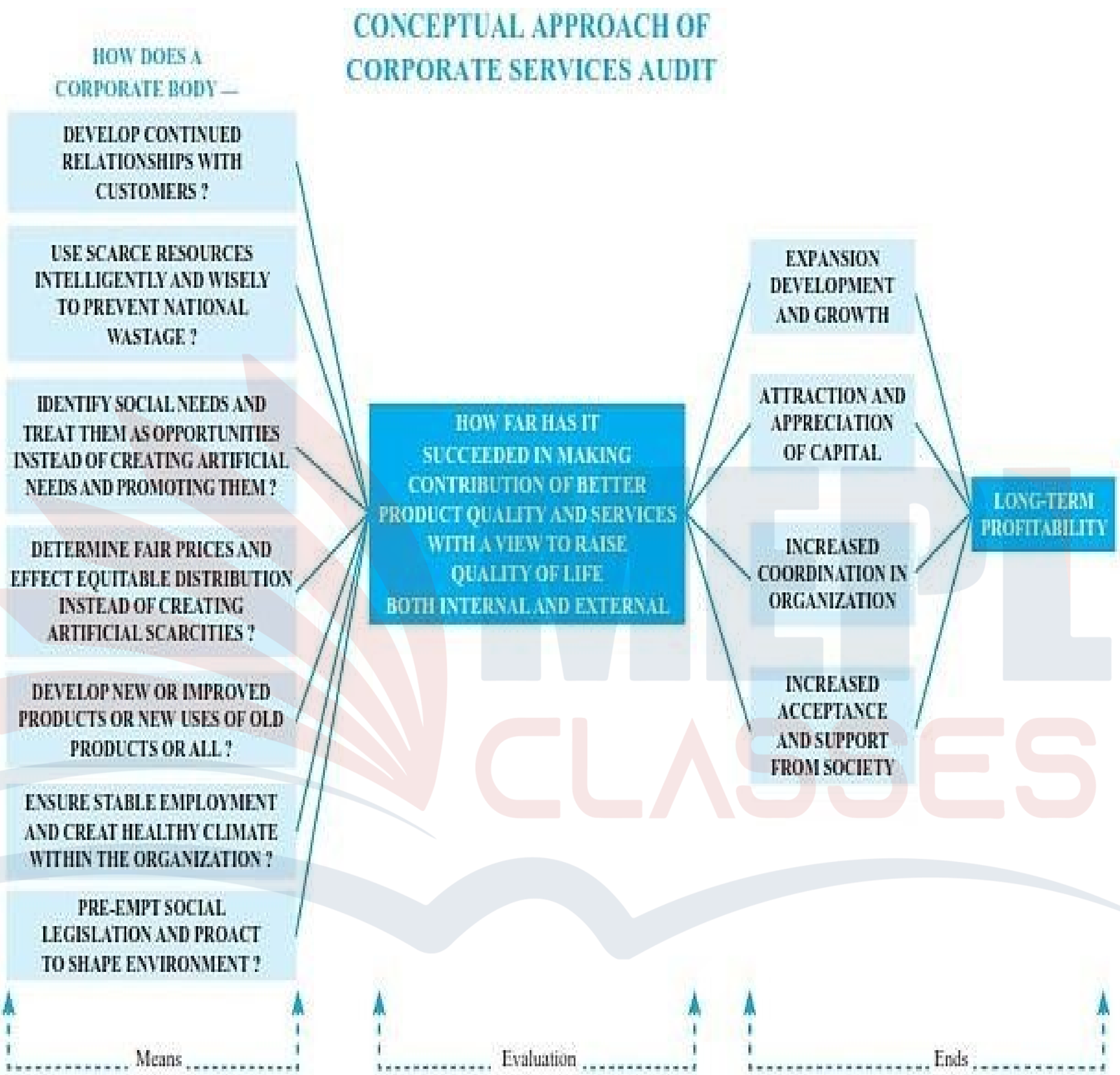
	• Audit of Energy & utilities • Productivity / Efficiency Audit • Proprietary Audit • CSR Audit • Social Cost Benefit Analysis Audit

CORPORATE SERVICE AUDIT

Obligation of the Corporate Entity towards the interest group

- Consumer
- Share Holder
- Fellow Businessmen
- Employee
- State
- Community


SCOPE OF CORPORATE SERVICES AUDIT
Interested
Groups
Consumers
Employees
Shareholders
Community
Fellow-businessmen
State
Scrutiny
and
Evaluation
Criteria
Quality, Products, in right quantities at— right price/place/time.
Pay, Safety, Welfare, Industrial relations, etc.
Social Cost, Social benefits i.e., Social Audit, Public relations.
Safety of investment, Satisfactory rate of return, Capital appreciation.
Business eithics, Relationships, Fair trade dealings, etc.
Compliance with the Spirit of law, Fair trade Practices, Payment of Taxes Services in times of State emergencies, etc.


CONCEPTUAL APPROACH OF CORPORATE SERVICES AUDIT
HOW DOES A CORPORATE BODY —
DEVELOP CONTINUED RELATIONSHIPS WITH CUSTOMERS ?
USE SCARCE RESOURCES INTELLIGENTLY AND WISELY TO PREVENT NATIONAL WASTAGE ?
IDENTIFY SOCIAL NEEDS AND TREAT THEM AS OPPORTUNITIES INSTEAD OF CREATING ARTIFICIAL NEEDS AND PROMOTING THEM ?
DETERMINE FAIR PRICES AND EFFECT EQUITABLE DISTRIBUTION INSTEAD OF CREATING ARTIFICIAL SCARCITIES ?
DEVELOP NEW OR IMPROVED PRODUCTS OR NEW USES OF OLD PRODUCTS OR ALL ?
ENSURE STABLE EMPLOYMENT AND CREAT HEALTHY CLIMATE WITHIN THE ORGANIZATION ?
PRE-EMPT SOCIAL LEGISLATION AND PROACT TO SHAPE ENVIRONMENT ?
HOW FAR HAS IT SUCCEEDED IN MAKING CONTRIBUTION OF BETTER PRODUCT QUALITY AND SERVICES WITH A VIEW TO RAISE QUALITY OF LIFE BOTH INTERNAL AND EXTERNAL
EXPANSION DEVELOPMENT AND GROWTH
ATTRACTION AND APPRECIATION OF CAPITAL
INCREASED COORDINATION IN ORGANIZATION
INCREASED ACCEPTANCE AND SUPPORT FROM SOCIETY
LONG-TERM PROFITABILITY
Means
Evaluation
Ends

So, the audit considerations include assessment of reactions to the following basic questions:

1. What a business may do in terms of available opportunities?
2. What a business can do in terms of capabilities and resources?
3. What a business wants to do in terms of aspirations, ambitions, and values of top management?
4. What a business should do in terms of response to society and its environment?

CORPORATE DEVELOPMENT AUDIT

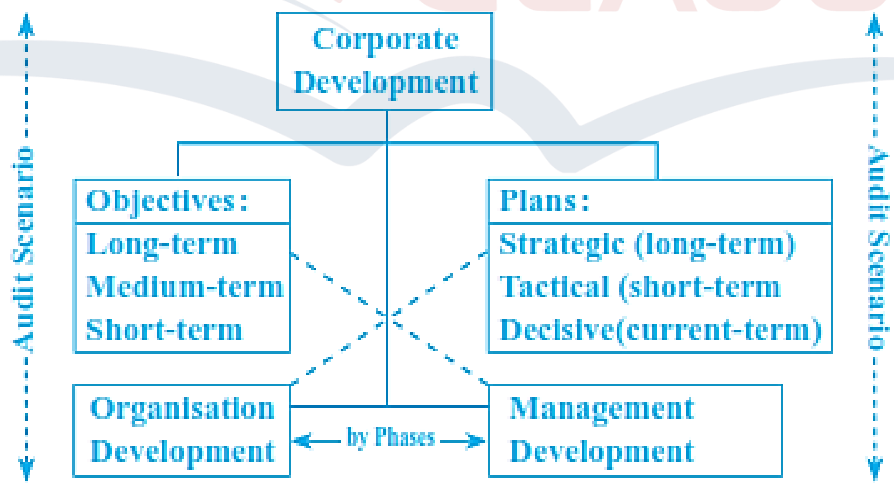
Potential	Kinetic Aspect
Plan / Policy / Procedure / Structure	Operations

How well is the organizational structure is formed (including Planning, Policies, Procedures, etc.) and the functions performed to achieve the set objectives.

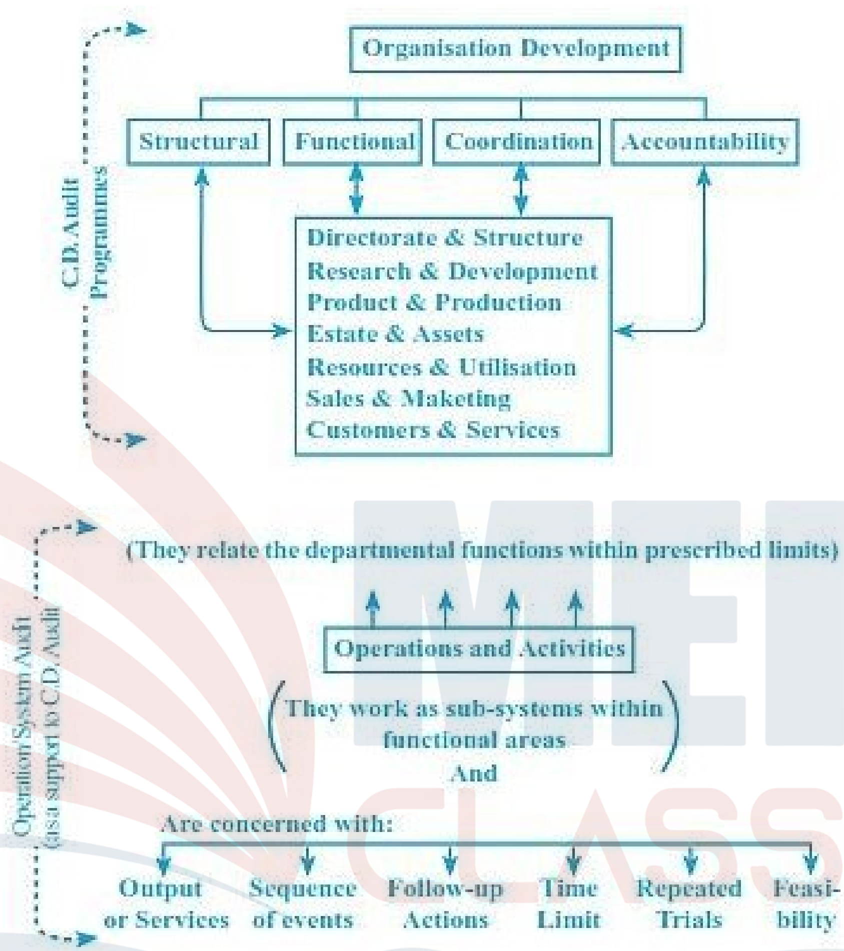
In the broadest sense of the term, there are four essential dimensions involved in corporate development audits-

1. Regularity: That means the different elements /parts of a body corporate are under constant watch.
2. Systematic check: This suggests the assessment of changing requirements of a corporate body in the context of forces generated from within and outside.
3. Review: This assesses past performance, its quality, and content, and its contribution to the corporate goals as definitively pronounced from time to time. This examines the deviations from goal realisation and suggests measures for achievement
4. Appraisal: This examines in detail the character, content, and quality of the corporate goals set matches the resources employed against the attainments recorded, and suggests the future course of action on the premise that nothing is taken for granted, even goals

- **Chart 1**



- **Chart 2**



Scope of Corporate Development Audit

a) Corporate Planning & Policy
   - Long Term

b) Corporate Forecasting o Medium Term or Short Term (1)Industry Plan (2)Market Share (3)National Economic Development
c) Corporate Strategy
d) Corporate Externalities
e) Corporate Internalities

Characteristics of Cost Development Audit

- Multi-directional or Multi-disciplinary Team.
- Planning & Decision Making.
- Achievements/Failures/Strength/Weakness.
- Point of Contact

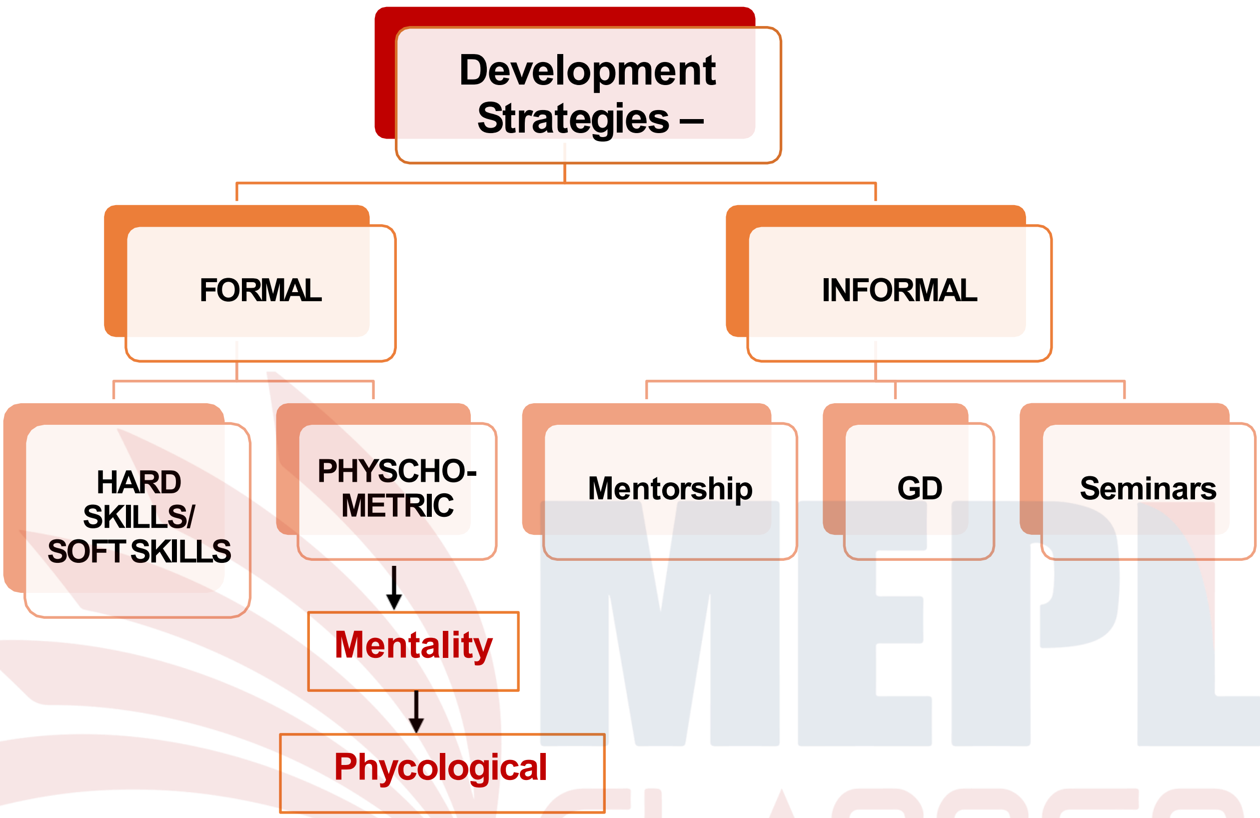
Corporate development audit seeks to assist the corporate management in assuring:

• The various factors and forces are working towards betterment of the Organisation.
• The motivational and coordination responsibilities are appropriately understood and implemented.
• The elemental responsibilities of planning, coordination, motivation, and control at departmental/functional management levels are discharged in the right spirit.

Evaluation of Personnel Development

Managers have an important role to play in ensuring development of people. Some of the most important things a manager can do for their team members are:

- Delegating responsibility rather than fixing problems before they arise.
- Honest and candid feedback for the development.
- Offering or suggesting specific appropriate development opportunities to employees.
- Motivating for additional risk and reward.
- Demonstrating the meaning of true LEADERSHIP attributes. (L.E.A.D.E.R.S.H.I.P. - LOYALTY, EMPATHY, ACCOUNTABILITY, DETERMINATION & DUTIFULNESS, ENCOURAGEMENT, RESPECT, SELFLESS, HUMBLE, INTEGRITY & INNOVATION, PASSION)



Performance Evaluation

Most companies conduct annual performance evaluations of employees against the task assigned in their KRA (Key Result Area).

The 'goal setting exercise' determines the role and assignment of broad areas. Periodical review exercise is carried out to evaluate and track the shortfall in achievement. Any mid-term intervention or changes also can be given effect based on the requirement. Annual review (performance appraisal) is a agglomeration of earlier period /s of the appraisal period. The basic objective is to provide feedback to employees for their role and organisational requirement.

- Rating Scales allow managers to rate the quality of an employee's performance or skills based on numerical values, wherein minimum and maximum is specified. Actual ratings given and accepted by employee placed normally in a 'bell curve' to identify top performers out of the total population.

- 360º Feedback mechanism perused in progressive Organisations where employees' managers, subordinates, and peers to provide feedback about performance of the employee from every angle. This can be a very useful form of evaluation, as some individuals can be wonderful managers but have a difficult time interacting with peers or vice versa. By gathering a wide range of perspectives, managers can pinpoint areas of strength and opportunities for growth. On the other hand, this approach can be problematic if the employee in question is less popular for any reason or if a supervisee is unhappy about being disciplined.

CONSUMER SERVICES AUDIT

Customer service is the experience an organisation's customers receive when they interact with an organisation. In any way; this includes business to business (e.g., where a farmer sells produce to a supermarket, or where a telecommunications company provides telephony services to a business) as well as business to consumer organisations (e.g., where an organisation interacts directly with individual customers such as a mobile phone company selling phones and contracts to an individual or a supermarket selling produce to the public).

The key principles of good customer service as –

- Respect towards Customer requirement
- Commitment towards a customer
- Provision of clear, relevant, and accessible information.
- Well-trained, customer-focused staff.
- Clarity in communication.
- Earliest resolution of customer complaints.
- Effective use of customer feedback.

Without customers, there is no need for the business at all:

- Customer satisfaction is monitored through customer surveys, usually administered by independent third parties or skilled internal resources.
- Customer service levels are monitored and measured against pre-defined targets.
- Customers have been identified and are consulted in meaningful ways, such as through focus groups.
- Customer satisfaction/survey/insight results are analyzed, communicated and action is taken from the information to derive benefit for the organisation.

- Accurate and reliable management information is in place related to all customer insight.
- There is an appropriate governance forum to discuss all customer insight at the executive level, and board level updates are provided on a periodic but regular basis.
- Key performance indicators and targets around customer service have been implemented and are monitored and tracked through customer insight.
- Colleague feedback is collected in real-time, analysed for trends, and action is taken where required.
- All customer input (views, complaints, feedback, online chatter, etc.) is viewed as valuable information and is analysed for trends and required actions.
- Social media is monitored in real-time and appropriate action is taken where necessary to deal with any issues or react to trends.

Specifics for customer service audit –

- Whether process of complaint registration exists?
- Whether a dedicated group of people are there to look after Customer Service?
- Whether the organisation having a documented policy to address customer complaints?

- Whether Customer WOW (wish on worth) measured for loyalty assessment?
- Whether any legal action filed against the entity for failing to cater Customer complaint?

- To track customer complaints? Tracking complaints can reveal patterns that then can be addressed. When complaints are not tracked, the same problems can exist forever.

Role of Internal Auditor

Internal audit has a key role to play in providing the board with reasonable assurance over customer service and complaint resolution process

- The internal audit activity should utilise customer service indicators such as risk metrics, complaints, product recalls, resolution process and time taken etc. for periodical reviews and other key indicators as a useful source of information for risk assessment.

- Customer service should be considered as part of the risk assessment and should also be considered for cyclical audits and included as a necessity for periodic coverage.

- Internal audit's role is to provide periodic independent assurance that controls are in place and operating effectively.

- Customer service data and satisfaction index for future guidance on Product and Customer behaviour.

- Cost of Poor Quality (COPQ) to highlight as a further scope for Product development.

Challenges for internal audit

Customer service is a key risk for organisations, and poor management of customer service can severely impact the reputation and commercial performance of organisations. Internal audit has a key role to play in providing the board with assurance that this risk is being managed effectively. The challenges faced are

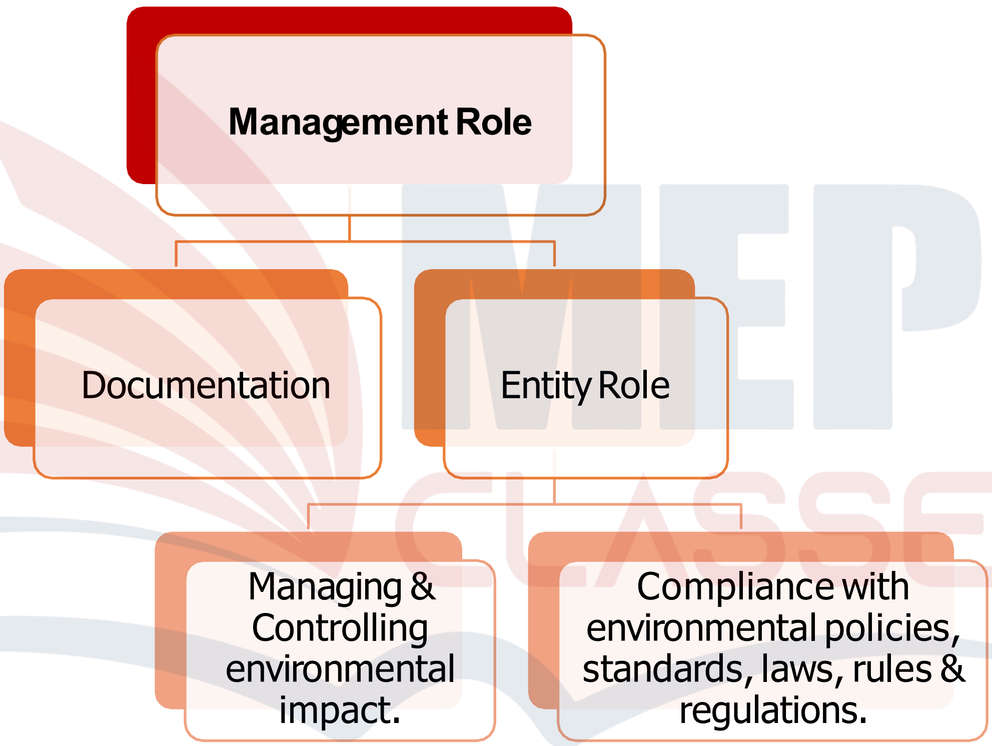
a) Failure to judge Customer requirement against Company's process of handling the complaint.
b) Absence or non - availability of requisite datum.
c) Lack of clarity over legal position and implications.

ENVIRONMENTAL PROTECTION AUDIT

USEPA	British Industry Confederation (1990)	ICC
Systematic, Periodic, Documented, Review of facility, operation and practice related to meeting environment requirement	Interaction of business with surroundings	Systematic, Documented & Periodic Review of environmental management& control
		• Environmental Practices are

		managed properly or not • Compliances

ENVIRONMENT AUDIT



Features of Environmental Audit

Role of Management:

Environmental audit performed through Internal Audit Team is generally considered as part of the internal control system and is mainly used to assess, evaluate and manage the environmental performance of a company including compliance against various legislations. It also includes recommendation for mitigation actions including proposition for Capex as to emerging risk

Environmental Impact Assessment (EIA):

Risk and impact is the basis for any mitigation plan. EIA is a tool used to predict, evaluate and analyze environmental impacts w.r.t upcoming Projects, mostly before a project commences, expansion plans etc. It assesses the potential environmental effects of a proposed facility. Whereas environmental audit looks at environmental performance for an existing operation or activity with impact assessment on account of non-conformity.

Systematic:

Audit is a systematic carefully planned, structured, and organized end to end process to ensure adequacy and result orientation for the environmental concerns. Since it is a part of a long-term process of evaluation and checking, it needs to be a replicable process so that over time, it can be easily used by different teams of people in such a way that the results are comparable and can reflect the change in both quantitative and qualitative terms.

Documentation:

Like any other audit, the base of any environmental audit findings also needs to backed-up and supported by proper documents and verifiable information. Management needs to ensure appropriate methods for environment related data collection and preservation, so that same can be perused for review and/or future reference purposes.

Continuous Review:

Monitoring of environmental performance against regulations and/or benchmarking the same is a continuous process. Regular collection of actual measurement datum and review, finding out 'root cause' for deviations from norms set can help in timely intervention and taking steps. The robustness of the process will help not only the entity nay the people stay nearby from the environmental hazards.

Objective Evaluation:

Other than environmental performance and compliance against specific regulatory matters, at times accreditation, certification, taking part in environmental survey etc. also comes up with enhanced objectivity. In addition to internal environmental audits, service of independent audit teams having specialized skills for repeat audits also resorted to. This is also required under many certification guidelines (e.g., ISO 14001).

Environmental Performance:

As mentioned before, the essence of any environmental audit is to find out how well the environmental management function performance in creating favourable impact and achieving organisational goal for environmental balance. The ultimate aim is to ensure that organisation's environmental performance meet the goals set in its environmental policy and also to ensure compliance with standards and regulatory requirements.

Objectives of Environmental Audit

The following are major objectives of environmental auditing:

- Determine and document compliance status.

- Help to improve environmental performance at operational facilities.
- Assist facility management.
- Increase the overall level of environmental awareness.
- Accelerate the overall development of the environmental management control system.
- Improve the risk management systems.
- Protect the corporation from potential liabilities on breaches.
- Conservation policy and application guidance.
- Fund allocation (Capex and Opex) and utilization w.r.t environment protection.
- Develop a basis for optimizing environmental resources.

Benefits of Environmental Auditing

• Improves efficiency of Environmental Management System (EMS)
• Compliance with environmental laws and standards
• Risk mitigation
• Meeting stakeholders' expectations

• Cost and environmental benefits, reduction in operational inefficiencies
• Linking operating processes and environmental impacts
• Compliance with certification requirements

STAGES OF AUDIT

- Pre-Audit
- On-site/Field Audit
- Past Audit
- Follow-up or Review Stage

Contents of Report:

A standard Environmental Audit report should include the following

• Executive Summary.
• Introduction/background to audit including specification of the entity/ process or activity/ system/ site in respect of which the environmental audit was conducted, and audit period.
• Object and scope of environmental audit.
• Audit observations

a) Status of conformity with internal environmental policies. i. Status of good environmental practices implementation. ii. Measurement and recognition of all significant environmental costs, benefits, assets, and liabilities and identification of significant environmental risks and contingencies. iii. Level of staff awareness of operational issues relating to environmental performance; and iv. Overall status of environmental performance
• Recommendations
• Actions agreed upon with target date and ownership
• Audit criteria.
• Evidence used.

Tools and Techniques Used in Environmental Auditing:

Some of the tools which can be used in environmental audits are:

- Checklists
- Questionnaires
- Questioning

- Observation
- Photographs
- Research

Audit of Energy and Utilities– Generation and Consumption

Electric/Natural Gas:

- Meterreading.
- Demand-based.
- Incorrect rate application.
- Incorrect tax.
- Multiplier/constant.
- Incorrect implementation of the contract.
- Incorrect application of tariff.
- Erroneous fees and taxes.

Water/Sewer:

- **Meter reading.**
- **Multiplier/ constant**
- **Incorrect application of surcharges.**
- **Incorrect meter usage.**

How Utility Cost Reduction Works

- Ensuring accuracy of billing rates charged by service providers;
- Consumption recording accuracy;
- Regulatory compliances;
- Equipment age and power consumed.

Energy Audit

Energy Audit is the key to a systematic approach for decision-making in the area of energy management. It attempts to balance the total energy inputs with its use and serves to identify all the energy streams in a facility. An industrial energy audit is an effective tool in defining and pursuing a comprehensive energy management programme. As per the Energy Conservation Act, 2001, Energy Audit is defined as "the verification, monitoring, and analysis of the use of energy including submission of technical report containing recommendations for improving energy efficiency with cost-benefit analysis and an action plan to reduce energy consumption".

Need for Energy Audit –

In any industry, the three top operating expenses are often found to be energy (both electrical and thermal), labour, and materials. Hence, cost reduction in energy consumption is of paramount importance. Energy Audit will help to understand more about the ways energy and fuel are used in any industry and help in identifying the areas where waste can occur and where the scope for improvement exists. The Energy Audit would give a positive orientation to the energy cost reduction, preventive maintenance, and quality control programmes which are vital for production and utility activities. Such an audit programme will help to keep the focus on variations that occur in the energy costs, availability and reliability of supply of energy, decide on appropriate energy mix, identify energy conservation technologies, retrofit for energy conservation equipment, etc.

Type of Energy Audit

The type of Energy Audit to be performed depends on –	• Function and type of industry. • Potential and magnitude of cost reduction.
Thus, Energy Audit can be classified into the following two types.	• Preliminary Audit. • Detailed Audit.

Preliminary Energy Audit Methodology:

A preliminary energy audit is a relatively quick exercise to:

- Establish energy consumption in the organisation.
- Estimate the scope for saving.
- Identify the 'low hanging fruits' i.e. most likely and the easiest areas for attention.
- Identify immediate (especially no/low-cost) improvements/ savings.
- Set a 'reference point'.
- Identify areas for more detailed study/measurement.
- A preliminary energy audit uses existing, or easily collectible data.

Detailed Energy Audit Methodology

A comprehensive audit provides a detailed energy project implementation plan for a facility since it evaluates all major energy-using systems. This type of audit offers the most accurate estimate of energy savings and cost. It considers the interactive effects of all projects, accounts for the energy use of all major equipment, and includes detailed energy cost saving calculations and project cost. In a comprehensive audit, one of the key elements is the energy balance. This is based on an inventory of energy-using systems, assumptions of current operating conditions, and calculations of energy use. This estimated use is then compared to utility bill charges. Detailed energy auditing is carried out in phases:

- Phase I - Pre-Audit Phase.
- Phase II - Audit Phase.

Phase I –Pre-Audit Phase Activities

<u>The main aims of this visit are:</u>

- To identify the main energy-consuming areas/plant Facilities to be surveyed during the audit.
- To identify any existing instrumentation/ requirement of additional metering facility at User Point from consumption trend e.g., KWh, steam, oil, or gas meters.
- To identify the instrumentation required for carrying out the audit.
- To plan with the time frame.
- To collect macro data on plant energy resources, major energy consuming centers.
- To create awareness on lowering consumption.

Phase II- Detailed Energy Audit Activities

The information to be collected during the detailed audit includes –

- Energy consumption by type /source of energy (Thermal, Hydro, Gas based etc.), by department, by major items of process equipment, by Utilities, support functions etc.
- Material balance data (raw materials, intermediate and final products, recycled materials, use of scrap or waste products, production of by-products for re-use in other industries, etc.)
- Energy cost and tariff data.
- Generation and distribution of site services (e.g., compressed air, steam).
- Sources of energy supply (e.g., electricity from the grid or self-generation).
- Potential for fuel substitution, process modifications, and the use of co-generation systems (combined heat and power generation).
- Energy Management procedures and awareness training programs within the establishment.

The audit team should collect the following baseline data –

- Technology, processes used, and equipment details.
- Capacity utilisation
- Amount & type of input materials used.
- Water consumption.

- Fuel Consumption.
- Electrical energy consumption.
- Steam consumption.
- Other inputs such as compressed air, cooling water, etc.
- Quantity & type of wastes generated.
- Percentage rejection / reprocessing.
- Efficiencies/yield.

Productivity Audit /Efficiency Audit

The term productivity, if simply put, may be 'output' divided by 'input'. 'Output' may mean goods as well as services. For 'input' we may come across diverse factors, such as men, materials, machines, land, capital, energy, organisation, and a host of others.

A critical examination of Efficiency Ratio, (that is, actual production in terms of standard hours to actual hours worked) and 'Activity Ratio' (that is, actual production in terms of standard hours budgeted production in terms of standard hours) may also form the content of productivity audit.

Factory – Actual Production = 5000 units

• Standard Hours = 10 hrs • Budgeted Production = 6000 units • Standard Hours = 10 hrs
Actual / Standard = 5000 / 10 = 500
Actual / Standard = 6000 / 10 = 600
500 / 600 = 0.83

Efficiency Ratio =(Actual Production/Std Hrs) /(Actual Production/Actual Hrs)
Activity Ratio =(Actual Production/Std Hrs) / (Budgeted Production/Std Hrs)

Problems of Productivity Audit

Productivity audit has to take care of and pay due consideration to these factorial inputs for measurement and evaluation:

- Factorial inputs have got different units or yardsticks of measurement.
- Inter-dependence of the different nature of work for the common inputs and their integrated final aim of productivity measurement. That means labour productivity, machine productivity, material productivity, the productivity of management and organisation function are closely inter-woven and inter-related.

- As a corollary to the above, the solution of the series of simultaneous equations, even if done by a computer, becomes somewhat of a subjective process. A unique mathematical solution is difficult to be worked out to the entire satisfaction of an auditor.

Propriety Audit

Propriety audit may be defined as 'Audit concerning the decisions of the executives, with an emphasis on stakeholders' interest, financial discipline, basically to get audit satisfaction that such decisions are within the frame-work of sanction, authority, rule, procedure and law made by a competent body. Propriety audit ensures that an expenditure incurred is duly sanctioned by an appropriate authority but should also investigate the justifications and the necessity for it.

Canons of Financial Propriety

i. Benefits accrued should be more than the spent.

ii. No authority should exercise its power of sanctioning expenditure to pass an order which will be directly or indirectly to his advantage.

iii. Public money should not be utilised for the benefit of a particular person or section of the community unless:

    a) The amount of expenditure involved is in significant, or
    b) A claim from the amount could be enforced in a court of law, or

c) The expenditure is in pursuance of a recognized policy or custom.

iv. The amount of allowances (e.g., travelling allowances) granted to meet the expenditure of a particular type, should be so regulated that these are not on the whole sources of profit to the recipients.

To assess the adequacy or otherwise of the effect of financial responsibilities, propriety, the audit should examine on the following broad lines:

1. Whether the technical estimates or detailed programme and cost schedules are being framed and that the same are adhered to; if not, whether there are adequate reasons for excess, delays, etc., or whether these are occasioned by inefficient handling, wastes, etc. or due to incorrect preparation of original estimates.

2. Whether there have been any serious avoidable delays in the progress of the schemes increasing the total cost of the scheme.

3. Whether there has been any wasteful expenditure including that resulting from lack of co-ordination.

4. Whether there have been any losses of recurring nature.

5. Whether the performance and cost compare with the results obtained in respect of similar schemes in other areas.

6. Whether physical targets have been achieved within the estimated or sanctioned time.

7. Whether the ultimate objectives of the expenditure have been fulfilled.

Propriety audit has its following limitations

In the decision-making process:	Since the auditor, examines and scrutinizes every decision for optimizing the spent; it often affects dynamism, progress and causes delay in decision making.
In compliance with Regulations:	Since the operations are rule bound, 'out of the box thinking process' crippled by the same and does not ensure the achievement of targets or objectives.
Timeliness:	The audit and its report, if delayed, will not be of much use. It will be a futile report on an unprofitable contract after incurring losses.

Presently the forms of organisation which is having the benefits of propriety audit are

- Government companies, such as the State and Central Government undertakings. The Comptroller and Auditor General of India has a right to conduct efficiency-cum economy-oriented propriety audit, in addition to the statutory audit under his guidelines and instructions.

- Under Companies Act both Chartered Accountants and Cost Accountants are empowered to perform Financial and Cost Audit respectively to ensure Companies are governed properly, which are propriety based.

- In the case of Government Companies, the Comptroller and Auditor General of India conducts the propriety audit.

Corporate Social Responsibility (CSR) Audit

CSR is mandatory as per SEC 135 of the Companies Act 2013

- Turn Over ≥1000 cr. or more
- Net worth ≥500 cr. or more.
- Profit ≥5 cr. or more

CSR policy functions as a built-in, self-regulating mechanism whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards, and international norms. A company is responsible for providing more benefits than just profits for shareholders.

All types of CSR information disclosure are effected by the need for credibility. Some examples are:

- Employees, to provide confidence in systems, establish progress against targets and improve confidence;
- Specialists, including analysts, particularly rating agencies, government officials, and NGOs;
- Business partners, to strengthen the supply chain; and
- Communities, to establish credibility with neighbors and local organisations.

In a report entitled "The State of Sustainability Assurance" published by Accountability, some of the main points were that:

i. Sustainability assurance is seen as a key element in building the quality and credibility of sustainability reporting, despite huge variations in the approach adopted, different forms of assurance conclusion, and a lack of credibility amongst preparers and stakeholders;

ii. Investors, regulators, and other stakeholders will become a powerful driver of sustainability assurance;

iii. Effective sustainability assurance will involve multi-stakeholder teams and enable disclosed information to have a better focus on what is material.

Internal Auditors might be involved in CSR at various levels-

1. Internal Auditors might facilitate or advise management on CSR self-assessment activities.

2. Internal Auditors might be involved in auditing CSR programs, either as individual components of the audit plan, or as a broad-based review of how CSR is managed, and whether the company is achieving its CSR objectives.

3. Internal Auditors might become involved in coordinating or participating in CSR Report verifications.

4. Proposed expenditure is made in areas demarcated /specified.

Internal auditors have an opportunity to make value additions to the Corporate Sustainability Reporting process of their organisation. They must have a good knowledge and understanding of prevalent CSR concepts. Important role internal auditors can play includes:
1. Assist in the design/ implementation of the CSR management system.
2. Perform limited scope audits requested by top management.
3. Perform compliance audits

Economic Performance	
i.	Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations, and other community investments, retained earnings, and payments to capital providers and governments.
ii.	Financial implications and other risks and opportunities for the organisation's activities due to climate change.
iii.	Significant financial assistance received.

Economic Benefit

Financial Assistance to Government

Employee
✓ Free Financial Assistance

Community Schools, Colleges etc. Carbon Foot print

Company Government contribution Benefit
Government Services Pollution
Carbon Foot print
CSR activities

Financial Assistance

Social Cost Benefit Analysis

Social cost related Benefit obtained

Input	Output
Social cost incurred	Benefit obtained from the cost incurred

Cost	Sales	Other Cost
Cost of Production	Revenue	Other activities

Cost of Sales		✓ School ✓ Park ✓ Employee Benefit ✓ Seminar
Revenue – Cost = Profit		

Project is viable or not

Financially
ROI

Commercially
Sales increase

Technicals
Technical
Expert

<u>**Presently, the appraisal process of a private concern's project takes into account:**</u>

- Financial aspects i.e., viability based on return on investment, etc.
- Commercial aspects i.e., marketing plan and strategies, etc., and
- Technical aspects i.e., technical parameters of project specification.

Social	
National Economy	
Leather Manufacturing	Animal Skins
	Viable - Endangered

SCB Analysis

Purpose

- Future Social Cost & Benefit
- Flow of Cost & Benefit
- Net Benefit (Benefit - Cost)
- Analysis what things to do to achieve maximum Benefit

Elements

- Objective of Project
- Future Benefit
- Future Cost
- Net Benefit

SCB Analysis =Future Expected Benefit (-) Future Expected Cost =Net Benefit Arrived from the intended project

SCB Analysis Techniques				
UNIDO			**LITTLE & MIRRLESS**	**India Planning Commission**
DCF Technique			L & M Method	Shadow Exchange Rate
IRR			Government hands income arise	Revalue
	Input Cost	Output Benefit	Uncommitted Social Income	
Y1	500	600		
Y2	600	800		
Y3	700	900		
IRR = 10%				
Time Value / Annuity etc.			Free Foreign Exchange	

SCB Analysis Techniques			
UNIDO	**LITTLE & MIRRLESS**		**India Planning Commission**
	India Country		
	Social Cost	Benefit	
	Cost Market Value		

	Developed Country		

Unido	**L & M**	**IPC**
DCF Technique IRR Market value measure benefit accrue	Developing countries Social Cost is more they measure Benefit in comparison with Developed economy	Government hands Income generate Shadow Exchange Rate
	Foreign Exchange	-
		Shadow Exchange Rate
	US | 1 USD | 10 USD **Shadow Exchange Rate**	

Government of India	
US	**India**
Benefit Measurable Terms →	Shadow Exchange Rate

SCB analysis is analysis of viability of a future project undertaken by the government or company in respect of cost incurred and benefit accrued. Since India is a developing country and here the amount of social cost is always greater then benefit accrue so we have to rely on shadow exchange rate for introduction of any social project.

SPACE FOR NOTES

SPACE FOR NOTES

SPACE FOR NOTES

Chapter 12 – EVALUATION OF CORPORATE IMAGE

Corporate Image / Corporate Identity

- How a corporate interacts with the public / present itself to public.
- It is a reflection of an organization in the mind of stakeholders or society at large.
- Trademarks, Product Design, Advertisement, Public Relation, Employees who are in direct contact with customers Logo, Title.

Apple →	iPhone/MAC Consumer	Windows Samsung
	Your (Stakeholder)	Other Consumer (General)

Major Elements of Corporate Image
Business & Financial Performance
Brand Image • Reputation & Performance of a Brand
Technological Strength of Company
Policy towards Employee

Relation with Customers / Stakeholders
Promoters / Leaders
Market Trends

Image versus Images

Only in the best of cases does a corporation enjoy a single reputation. Different publics may have different views of the corporation depending on their different interests and experience with the organisation. A company's brand image may be very good but its reputation among suppliers is poor, because it bargains very hard, pays late, and shows no loyalty to vendors. A company may be highly regarded on Wall Street but may be disliked on the Main Street of cities where it has closed plants. A company may be valued for providing very low prices yet disliked for its employment practices or in different environmental performance. It is much more likely that a small business will have an all-around reputation for excellence than that a very large conglomerate will merit all-around praise. Smallness has its advantages.

At the Core: Business Performance

- ✓ The single most important factor in the corporate image is a Company's core business performance reflected through financial performance.

- ✓ A growing, profitable corporation with a steady earnings history will, for these reasons alone please its customers, investors, and the community in which it operates.

- ✓ Enron Corp., an energy trader, had a stellar reputation as the 7th largest corporation measured in revenues. It fell into bankruptcy almost abruptly on December 2, 2001; the Justice Department began to investigate it for fraud. Suddenly every aspect of the company that had been admired and lauded, its audacity, energy, profitability, innovativeness, entrepreneurial spirit, and so on took on opposite and negative connotations.

- ✓ The core business had failed; Enron's reputation imploded. No amount of corporate image polishing could have saved Enron'sreputation after that.

Measuring the Corporate Image

- Corporations evaluate their image, much as politicians do, by the survey. They employ the methodology of marketing surveys used both in polling and in support of advertising.

- The theory of the corporate image holds that all things equal, a well-informed public will help a company achieve higher sales and profits, whereas a forgetful or poorly informed public may come to hold negative impressions about the company and may ultimately shift more of its patronage toward competitors.

Measuring of Corporate Image	
POLL	**Advertisement**

Survey

Words and Actions

- The example of Toyota is a case in which Toyota felt the need to communicate ("words") something about its investments ("action") in the United States.
- "A vast army of goodwill ambassadors."
- The company should communicate all their actions through the various channels of corporate images / communication such as Employees, Advertisement, Website, TV, social media etc.
- Higher the reputation of the company at the society at large – Better the business performance. (ways to reduce Reputational Risk)

  →Brand Name

  →Website design

  →Quality of Product & Services

  →Vendor Payment

  →Employee relation

Corporate Image
→ Image of the company to the Society → Relation of the company with the Public
PRO/CCO – CEO/Chairman Public Relationship Officer / Chief Communication Officer

PRO/CCO
→ Academic degree in communication (Degree in Mass Communication)
→ Handle the information of the company both internally and externally
→ Media Relations

PRO/CCO:- Essential traits of PRO/CCO

- Academic Qualification
- Knowledge of communication
- Internal & External communication
- High standard of Integrity & confidence of people

Responsibility of PRO

- Brand Image develop & maintain
- Communicating with PR Agency
- Internal & External communication
- Communication network (Media Relation)

PR Agency:- These are PR service provider which helps in strategically planning & building Corporate Image

Reliance: -

PR Agency

- Planning
- Media Relationship
- Key Message

Media Relationship	Key Message
Social Media	Mission Vision
Newspaper (Print Media)	Finance Performance
TV	Promoter

			Future Prospects

Types of Communication Relation

Investor Relation	Media Relation	Public Relation
Communication of image is through the Financial Performance & returns achieved by the company	Communication of organization mission / vision / policies / practices through various types of media such as Mass Media	Communication of information by the organization with the help of various communication channel to the public to influence their perception
	Mass Media refers to Communication where information / communication is happening with large sections of people (large population) For Ex:- News Channel, News Paper, TV Ads, etc.	Ability to hear or become aware of something through senses
	Mass communication is the process of spreading information to large number of people with the help of Mass Media → Advertisement	i.e. by seeing a newspaper add about a Discount

	→ TV News → Newspaper → Scoops (News Image) → Publicity Stunts	
	(Persuasion oriented)	Experience the customer have at first interaction with the company
	Make someone to belief in something by speech or action	
	For Ex- TV Debate etc.	

Customer Experience is always perception oriented	They give feedback about their perception i.e. the communication which they made with the company / product with their sense **For Ex: -** → Feel / touch of the I-phone → Quality of Food products

Too much of reliance on Media / Mass communication may lead to corporate defamation.

↓

Corporate Defamation means loss of image of the company to the society / stakeholders by an action by the person / individual / PR agent / Media relation officer.

Libel	**Slander**
"Publication" of a false and defamatory statement to injure the reputation of another person without any justification	False and defamatory statement by spoken words or gestures tending to injure the reputation of another person

Corporate Defamation means loss of image of the company to the society / stakeholders by an action by the person / individual / PR agent / Media relation officer.

Libel	**Slander**
For Ex:- Publishing News Article / Blog / Social Media Post containing wrong information	
Printed / Published Statement	Just words spoken

Communication

Internal	**External**

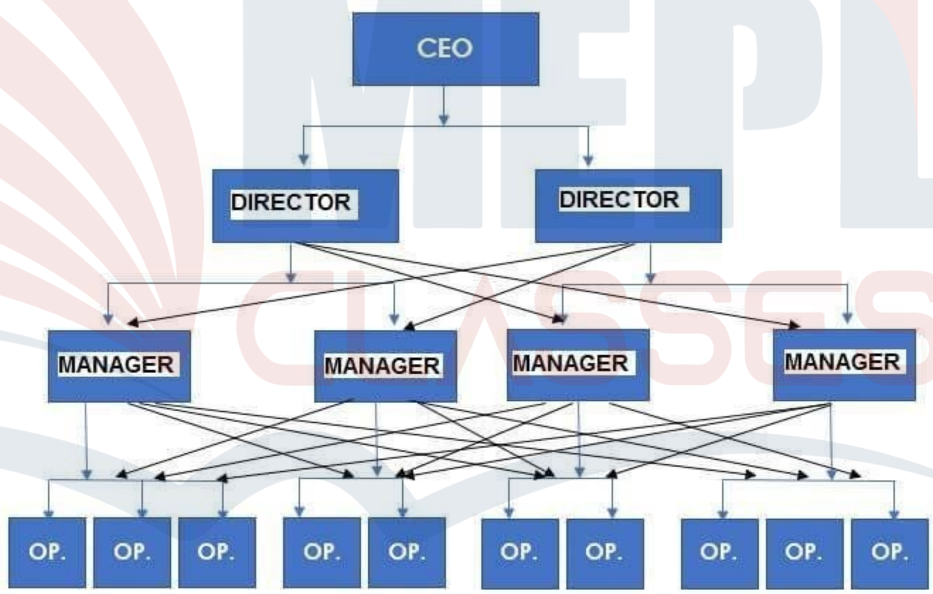
Employees / Managers / Investors etc. with the help of various channels such as company's website, other internal publications such as notice, journal etc.	Using external communication channel to communicate with stakeholders & communities
Organizational strategies, policies, procedures	Product Design, Vision, Mission, objective, Financial Performance etc.

Audit check on Different Managerial function

Functions of Management

Administration Industrielle et Generale 1916

Henri Fayol (POCCC)	
Planning	Planning is a function of management that involves setting objectives and determining course of action to achieve the set objectives
	Steps of Planning • Environmental Scanning • Forecast Future conditions • Objectives establish • Course of action

	• Success of plan & corrective action
	Types of Planning • Strategic Planning (SM) – SWOT Analysis • Operational Planning – Operations of the organization
Organizing	It involves developing on organization structure and allocating human resource to ensure accomplishment of objectives  **"Organizational structure / Organizational design"**
	On the basis of the design there is distribution of Job which are to be carried out for the achievement of goals or objectives ⬇

	"JOB DESIGN"
Commanding / **Coordinating**	**Leading**: Involves influencing others towards attainment of organizational objectives → Leadership skills to motivate the employees to do their work effectively for attainment of organizational objectives → Lead from the front
Controlling	It involves ensuring the performance does not deviate from standards • Establishing performance standards • Comparing actual performance against standard • Taking corrective action when necessary [This function does not involves controlling the behavioral aspects – Only work-related activity – controls]

Two traditional control techniques are: -

1. Budget
2. Performance Audit.

Functions of Management Audit

- Identify the objective of Management
- Performance standard
- Review of structure of organization
- Scope of work Deviation from standard
- Interest of stakeholders

Scope of Management Audit

Scope of Management Audit
• Organization Structure
• Operation effectiveness of Management
• Performance appraisal
• Goals / Policies / Objectives of Management
• Independently by expert

Management Audit covers the following Area

Management Audit & Its Scope

Studying the organization	Searching for performance shortcoming
	Arrear of appraisal identified by "American Institute of Management"

1. Economic function vis-à-vis social responsibility • It talks about the companies performance in social area • Community at large
2. Corporate structure • Internal Communication or flows of information internally
3. Earning Growth & Business Prosperity • Growth of earning on year-on-year basis
4. Service to the stakeholders • Risk minimization on investment • ROI • Capital appreciation
5. Research & Development • Pharma industry

6. Constitution of BOD • Quality of each Director & their contribution • Role as an influencer • Team work • Trusteeship Role
7. Fiscal & Financial policies
8. Operational effectiveness

Objectives of Management Audit
• The level of achievement of the objectives of the organization
• The shortcomings and barriers to achievement
• Control mechanism to pre-empt possibility of leakage orsabotage
• To conduct efficient administration of the operations
• Effective discharge of their responsibilities
• The management the ways and means available to achieve the objectives
• To guide towards improved performance
• To improve operations and achieve operational excellency

- The management efficiency

Management Audit Need

- Policies laid by the Company
- Performance Improvement
- Independent appraisal of Performance
- SWOT
- Effectiveness of Decision Making
- Operational efficiency
- Good Governance practice

Management Audit Importance

- Setting the objectives & policies
- Improving the system

Improving the performance
Provides a Roadmap ⬇ • **Overall organization improvement**
Set the direction of policies and business

Process adopted for implementation of Management Audit

- Objective for Introducing Management Audit System
- Critical appraisal

Management Audit Approach

- Effectiveness of Organization structure
- Performance evaluation & appraisal
- Adherence to statutory regulation
- Appraisal of MIS
- Policies & Procedures for achievement of objectives

Checklist of Various Corporate Divisions / Departments

1. Strategic Business Planning

- The SWOT for accomplishment of the goals.
- Whether SMART (Specific, Measurable, Achievable, Relevant, and Timeframe) set of Goals are in place and cascaded down function-wise for accomplishment?

2. Organizational Structure

- The smooth decision-making process with appropriate and adequate information movement.
- The employees are clear about their roles, responsibility and accountability.

3. Finance & Accounting

- Accounting function manned with qualified accountants
- Company's accounting activities are carried out through accounting software.
- Accounting function, recording, supervision, approval, report generation etc.
- Appropriate review mechanism is in place over the accounting activities.

4. Tax

- Tax calendar to monitor deposit, return dates against each of the applicable tax legislation.
- Tax law/rules-wise responsibility fixed to ensure compliances
- Decided to contest against any query from appropriate revenue exchequer.

5. Budgeting

- Budgeting exercise carried out for all the major activities e.g. sales, purchases, advertisement, HR, Marketing, Training.
- Approval obtained for such budgets

6. Cash Management

- Budget of inflow and outflow of Cash for business
- surplus funds are invested /deployed efficiently

7. Pricing and cost-saving

- The entity having a flexible pricing policy to address the market dynamics of demand, supply, competition, aggressive players' strategy and quality etc.
- The entity having a product and/or price leadership position
- 'Make or Buy' decisions are explored to gain advantages in rising plant cost scenario.

8. Purchasing

- Well defined authority structure for purchase decisions is in place.
- Costing Team, sales and manufacturing Team for price/ rate change of items.
- The purchases are made at the best available price

9. Marketing

- Sales organization with defined goals /targets
- To make its strategy, promotion activities and thwart competition

10. Risk & Insurance

- Business risks analyzed and responded and opportunities explored
- Whether non-transferable risks are reviewed regularly for appropriate cost-effective mitigation plan.

i. Evaluation of Purchase Management
ii. Evaluation of Personnel Management
iii. Evaluation of Production Management.
iv. Evaluation of Research and Development Activities
v. Marketing Audit
   a) Evaluation of Sales Management
   b) Evaluation of Distribution Function

Whether non-transferable risks are reviewed regularly for appropriate cost-effective mitigation plan

1. **Evaluation of Purchase Management:**

   The primary objective of purchase management is to procure raw materials, packing material etc. of the requisite quantity of required quality at a reasonable cost at the right time.

2. **Evaluation of Personnel Management:**

   The main objective of personnel function is to create such conditions in the organization that the employees can put to their best performances. The personnel manager has to assess manpower requirement, selection, recruitment, training and development of individuals to get best out of the employee, and also to ensure favorable industrial relations, grievance redressal, discipline, wage settlements etc.

3. **Evaluation of Production Management:**

   The main objective of production management is to turn out finished goods of requisite quality by making optimum use of men, machines, and methods. The productivity of such factors must satisfy the standards or norms set for the industry.

4. **Evaluation of Research and Development Activities:**

   A management auditor of a company can appraise and evaluate activities of research and development based on the following checklist:

   a) The entity having a vision to achieve the above through R & D.

   b) Budget prepared for R & D spent.

   c) Appropriate Quality of people manned in R & D.

d) The Board of Directors identify or endorse the broad "types of research" to be undertaken

5. Marketing Audit:

Marketing audits may be horizontal or vertical. A horizontal audit (also known as a system-level audit) covers a major part of a marketing audit and evaluates a total appraisal of the marketing efforts of a company.

The marketing audit encompasses the following areas:

a) **Objectives:** Target setting and methods for accomplishment of objectives in detail.

b) **Programme:** Appraising efficacy of marketing programs for achieving the objectives.

c) **Organisation:** Structure, roles of marketing department.

i. Evaluation of Sales Management

The main objective of the function of sales management is to create and develop market (customers) and take the 'pole position'.

The following questionnaire will help in evaluating sales management:

a) SWOT for different geographical or Customer segment is carried out for planning the marketing effort.

b) Quality of product justifies 'price' and returns are bare minimum.

ii. Evaluation of Distribution Function

A. Distribution Function

B. Capacity configuration

C. Staging of inventory

D. Transportation mode mix

ESG Audit

- SEBI (Listing obligation & Disclosure Requirement) Regulation, 2015.
- May 21 issued notification for Top 1000 listed companies as per Market Cap.
- Sustainability is fast becoming a key priority for corporates around the world. Businesses today are expected to be more ethical and duty bound towards society.
- Mandatorily submit BRSR (Report) along with the annual report where they need to make disclosure about their fulfillment of certain ESG based parameters.
- FY – 22-23
- Mandatory compliance for top 1000 Listed Companies
- Other than 1000 voluntary

Prior to this a report (BRR) – Business Responsibility Report – 2012 [Top 100]

How does India view ESG compliance?

→ In 2013, India became the first country to mandate corporate social responsibility with the Companies Act of 2013.

→ National Voluntary Guidelines (NVGs) on Social, Environmental, and Economic Responsibilities of Business released in 2011 before being included in the Companies Act 2013.

→ The top 500 listed firms in India by market-cap were instructed by SEBI to disclose indicators of business responsibility and sustainability through Business Responsibility Reporting (BRR).

→ In 2021, SEBI issued a circular containing details of new sustainability-related reporting requirements called the Business Responsibility and Sustainability Report (BRSR), which brings India's sustainability reporting to global reporting standards. BRSR is a departure from the BRR format.

What are the disclosure requirements under India's new ESG policy?

→ SEBI issued a circular introducing the Business Responsibility and Sustainability Report (BRSR).

→ The top 1000 listed companies by market capitalization.

→ The RBC Guidelines are influenced by leading international standards, including the UN Guiding Principles on Business and Human Rights, UN Sustainable Development Goals, Paris Agreement, and International

Labour Organisation (ILO) Core Conventions. The RBC Guidelines addresses key sustainability matters, such as business ethics and transparency, human rights, environmental safety, and fair labour practices

→ The reporting format is mandatory from FY 2022-23 but is voluntary for FY 2021-22.

9Principles on which disclosures to be made in BRSR report as per SEBI

Principle 1:	Businesses should conduct and govern themselves with integrity, and in a manner that is ethical, transparent, and accountable. **Essential Indicators:** → Details of fines / penalties / punishment / award / compounding fees / settlement amount. → Details of anti-corruption or anti-bribery policy **Leadership Indicators:** → Processes to avoid / manage conflict of interests involving members of the Board / KMPs.
	Businesses should provide goods and services in a manner that is sustainable and safe.

Principle 2:	**Essential Indicators:** → Sustainable sourcing → Processes in place to reclaim products for reuse, recycle and safe disposal of products at the end of life **Leadership Indicators:** → Life cycle assessment → Recycled or reused input material as percentage of total input material. → Reclaimed products and their packaging materials.
Principle 3:	Businesses should respect and promote the well-being of all employees, including those in their value chains. **Essential Indicators:** a) Gender and social diversity. b) Turnover rates c) Median wages. d) Welfare benefits to permanent and contractual employees. e) Occupational health and safety. f) Trainings **Leadership Indicators:** → Rehabilitation and suitable employment of employees / workers.

Principle 4:	Businesses should respect the interests of and be responsive to all its stakeholders. **Essential Indicators:** → Process for identification of key stakeholders. → Key stakeholder groups. **Leadership Indicators:** → Using stakeholder consultation to support the identification and management of environmental, and social topics. → Details of instances of engagement with and actions taken to address the concerns of vulnerable / marginalized groups.
Principle 5:	Businesses should respect and promote human rights. **Employees:** a) Gender and social diversity b) Turnover rates c) Median wages d) Welfare benefits to permanent and contractual employees e) Occupational health and safety. f) Trainings

Principle 6:	Businesses should respect and make efforts to protect and restore the environment. **Essential Indicators:** a) Resource usage (energy and water) and intensity metrics. b) Air pollutant emissions Environment. c) Greenhouse gas emissions (Scope 1, Scope 2, and Scope 3). d) Waste generated and waste management practices e) Impact on biodiversity
Principle 7:	Businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent. **Leadership Indicators:** Details of public policy positions advocated by the entity.
Principle 8:	Businesses should promote inclusive growth and equitable development. **Essential Indicators:** a) Social impact assessments b) Rehabilitation and resettlement c) Corporate social responsibility

	Leadership Indicators: • CSR projects undertaken in aspirational districts • Details of the benefits derived and shared from the intellectual properties owned or acquired by your company based on traditional knowledge shared. • Details of beneficiaries of CSR Projects
Principle 9:	Businesses should engage with and provide value to their consumers in a responsible manner. **Essential Indicators:** • Details of instances of product recalls on account of safety issues. **Leadership Indicators:** • Channels / platforms where information on goods and services of the business can be accessed. `

How big Indian companies are adapting to the ESG pivot

Many leading companies in India have begun to include environmental, social, and governance targets as a part of key result areas(KRAs) for Top Management.

The move is influenced by an increasing push from investors to allocate capital that not only generates financial returns but is also invested in social good. Overall, non-financial factors increasingly become a marker of material risks and growth opportunities for investors.

The pandemic and increasingly evident costs of climate change have elevated the importance of these discussions, with many boards devoting significant time in their strategy meetings to discuss ESG issues.

How India compares with other countries:

To have mandated corporate social responsibility

However, different countries have different approaches and beliefs when it comes to ensuring responsible business activity.

The United Kingdom:

Companies are mandated to provide a report disclosing annual greenhouse

gas emissions, diversity, and human rights under the Companies Act 2006 (Strategic and Director's Report) Regulations, 2013.
Companies with a premium listing of equity shares in the UK also need to report on how they apply the main principles of the Corporate Governance Code, 2012.

European Union:

The European Commission (EC) Directive on Disclosure of Non-Financial and Diversity Information (2013) is considered a major reporting instrument of the EU.
It requires certain large companies and public-interest companies to disclose material environmental, social, and employee-related matters.

United States:

The US Securities and Exchange Commission (SEC)

The New York Stock Exchange (NYSE)

China:

- The Environmental Information Disclosure Act, corporations to disclose environmental information.

SPACE FOR NOTES

SPACE FOR NOTES

SPACE FOR NOTES

TYPES OF CORPORATE NAMES

TYPES OF CORPORATE NAMES

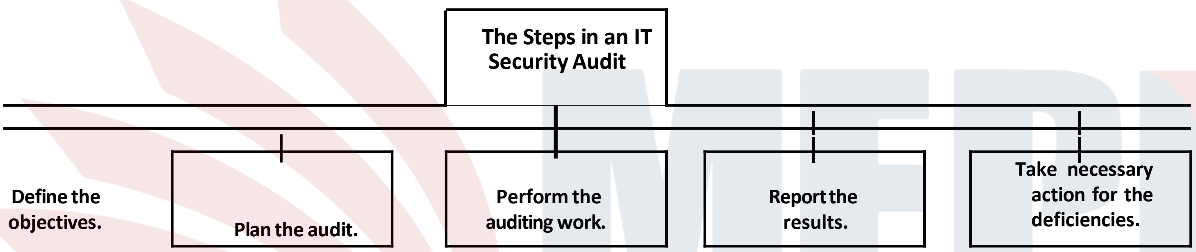
- **1. Overt**
  - Reveals what the company does
    - Indigo "Airlines"
    - American Airlines
    - Kraft Food
    - Jubitant Food
- **2. Implied**
  - Contains words or clues that conveys what company does
    - FedEx, IBM
- **3. Conceptual**
  - It captures the essence of what the company offers
    - Example: Google (Evokes a sense of place where endless number of items can be found)
- **4. Iconoclastic Name**
  - Represents something unique, different and memorable
    - Monster.com
    - Godaddy.com

CHAPTER – 13 INFORMATION SYSTEMS SECURITY AUDIT

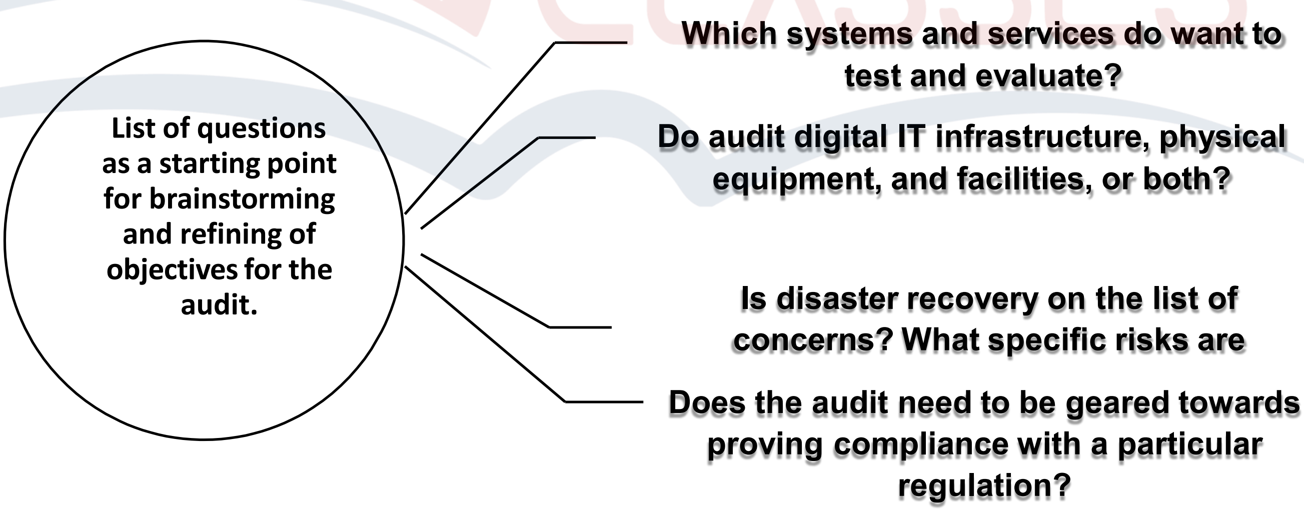
- **An information systems security audit (ISSA) is an independent review and examination of system records, activities, and related documents**
- **The term "security framework" has been used in a variety of ways in security literature over the years, but in 2006, it came to be used as an aggregate term for the various documents, some pieces of software, and the variety of sources that advise on topics related to information systems security, in particular, about the planning, managing or auditing of overall information security practices for a given institution.**
- **In simple terms, it is the entire security of the IT System.**
- **An IT security audit is a comprehensive examination and assessment of an enterprise's information security system.**
- **An audit can help to answer the following critical questions**
- **Are there any weak spots and vulnerabilities in current security?**
- **Are there any extraneous tools or processes that don't perform a useful security function?**
- **Are equipped to fend off security threats and recover business capabilities in the event of a system outage or data breach?**

- **If discovered security flaws, what concrete actions can take to address them?**

- **A Compliance Audit is typically conducted by a certified security auditor from either the applicable regulatory agency or an independent third- party vendor. In some cases, though, personnel within the company may perform an internal audit to check the company's regulatory compliance or overall security posture.**



DEFINE THE



PLAN THE AUDIT

- A thoughtful and well-organized plan is crucial to success in an IT security audit
- Define the roles and responsibilities of the management team and the IT system administrators assigned to perform the auditing tasks, as well as the schedule and methodology for the process. Identify, monitor, report, and data classification tools that the team will use and any logistical issues they may face, like taking equipment offline for evaluation.
- Once decided on all the details, document and circulate the plan to ensure that all staff members have a common understanding of the process before the audit begins.

PERFORM THE AUDITING WORK

- The auditing team should conduct the audit according to the plan and methodologies agreed upon during the planning phase. This will typically include running scans on IT resources like file-sharing services, database servers, and SaaS applications like Office 365 to assess network security, data access levels, user access rights, and other system configurations.
- Also physically inspect the data center for resilience to fires, floods, and power surges as part of a disaster recovery evaluation. During this process, interview employees outside the IT team to assess their knowledge of security concerns and adherence to company security policy, so any holes in the company's security procedures can be addressed moving forward.

REPORT THE

- **Compile audit-related documentation into a formal report that can be given to management stakeholders or the regulatory agency.**
- **The report should include a list of any security risks and vulnerabilities detected in IT systems, as well as actions that IT staff recommend to mitigate them.**

TAKE NECESSARY ACTION

Follow through with the recommendations outlined in the audit report.

Examples of security-enhancement actions can include:

- Performing remediation procedures to fix a specific security flaw or weak spot/s.
- Training employees in data security compliance and security awareness.
- Adopting additional best practices for handling sensitive data and recognizing signs of malware and phishing attacks.
- Acquiring new technologies to strengthen existing systems and regularly monitor infrastructure for security

SECURITY AUDIT AND RISK ASSESSMENT

SECURITY AUDIT	RISK ASSESSMENT
EXMINATION AND EVALUATION OF SECURITY RELATED RISK OF IT SYSTEM	EXAMINATION AND EVALUATION OF SECRITY RELATED RISK OF IT SYSTEM
IT IS PERFORMED ON THE EXISTING IT INFRASTRUCTURE	STARTING ON ANY IT TOOLS AND TECHNOLOGY BEING INTRODUCED
IT EVALUATES THE SECURITY OF CURRENT SYSTEM	IT IS PERFORMED TO CHECK WHETHER THE NEW SYSTEM / TECHNOLOGY CAN BE IMPLEMENTED
PERFORMED BY INDEPENDENT EXPERTS TO CHECK THE IT SYSTEM SECURITY OF THE ENTERPRISE	IT IS PERFORMED AT REGULAR INTERVALS

To make sure that security audit is effective in identifying flaws and weaknesses in the IT system, follow these best practices.

ESTABLISH CLEAR OBJECTIVES

- **Clearly defining goals and scope keeps the audit on track to be measurable, actionable, and successful.**
- **And when all members of the auditing team stick to the defined objectives, they can stay focused on critical tasks and avoid wasting valuable time and resources on irrelevant or unnecessary issues.**

OBTAIN BUY-IN FROM KEY STAKEHOLDERS

- **For an infrastructural initiative like a security audit to be successful, there is a need for support and advocacy from the top levels of the organization, including the chief security officer and chief information officer.**
- **Management sponsorship will help ensure that the audit gets the time and resources that are required.**

DEFINE CLEAR ACTION ITEMS BASED ON THE AUDIT

- It's not enough just to publish a report of findings.
- The audit should contribute to the security of the organisation by providing clear and practical guidelines for making cybersecurity improvements.
- If there's a system vulnerability, create a plan for how to remediate it.
- If a file or data system is out of regulatory compliance, take the necessary measures to bring it into compliance.

SECURITY AUDIT SOLUTIONS

- IT security auditing is most useful and effective when conducted regularly.
- Create a schedule to periodically audit the entire system portfolio to assess compliance with data regulations and maintain operational readiness for cyber attacks

COMPLIANCE AND SECURITY

BANKS TO GIVE REPORT TO CSITE CELL

- GAP ANALYSIS AGAINST THE PUBLISHED CYBER SECURITY FRAMEWORK
- INFORMATION SECURITY ANALYSIS
- EFFECTIVENESS OF IMPLEMENTED CONTROL
- PLAN OF ACTION TO MITIGATE RISKS
- ROLE OF CHIEF INFORMATION SECURITY OFFICER

HOW RBI AUDIT IS PERFORMED FOR A BANK?

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

RBI AUDIT REPORT

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

RBI CYBER SECURITY FRAMEWORK

Following are the Baseline controls:

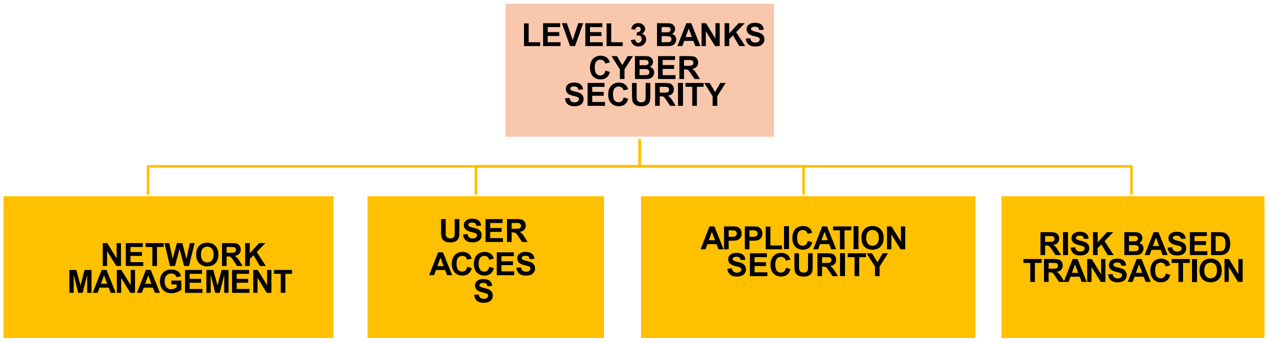
- Inventory Management of Business.
- IT Assets Preventing execution of unauthorized software.
- Application Security Life Cycle (ASLC).
- Patch/Vulnerability & Change Management.
- Vendor Risk Management.
- Removable Media.
- Maintenance, Monitoring, and Analysis of Audit Logs.
- Audit Log settings.

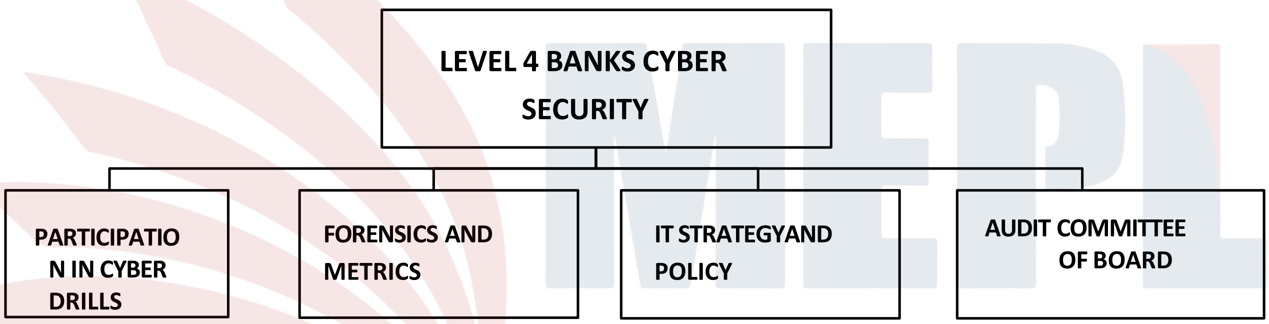
Level 1 Banks Cyber Security

- Baseline Cyber Security and Resilience Requirement.
- Vendor/Outsourcing Risk Management.

LEVEL 2 BANKS CYBER SECURITY

- NETWORK MANAGEMENT AND SECURITY
- SECURE CONFIGURATION
- ANTI-PHISHING
- AUDITLOGS
- INCIDENT RESPONSE AND MANAGEMENT





CYBER SECURITY AND CYBER FORENSICS

What is Cyber Security?

- **Cyber security is a professional discipline that is about creating defensive measures to protect against cyber-attacks.**
- **People working in this industry may have a wide range of information technology (IT) skills including programming, operating systems, and networking.**

- The primary goal of any cyber security professional is to create a network or system that is impossible to breach, thereby protecting the information within the network.
- Cyber security encompasses many protocols that are used in the real world. Things like setting user permissions, establishing file.
- transfer protocols (FTP), and requiring secure, frequently changing passwords are all vital elements of cyber security.

What is Computer Forensics?

- Computer forensics is the practice of recovering data from a device, often to uncover evidence of criminal activity.
- The practice itself is reactionary, meaning that it only takes place after an incident has occurred and is not concerned with preventing the incident itself.
- Computer forensics jobs typically serve one of two purposes.
- They either assist with an investigation or help people and companies recover data that has been lost

CYBER SECURITY VS. COMPUTER FORENSICS

- In short,
- cyber security is focused on prevention while computer forensics is about recovery and reaction.
- Despite their differences, both are meant to protect data, programs, networks, and other digital assets.

- **Cyber security helps to prevent cyber-crimes from happening, while computer forensics helps recover data when an attack does occur and also helps identify the culprit behind the crime.**

WHAT SPECIALIZATIONS ARE AVAILABLE IN CYBER SECURITY AND COMPUTER FORENSICS?

- **Cyber security and computer forensics both have a few specializations that focus on specific areas of the practice.**
- **Cyber security has far more specializations, such as systems architecture, software security, access management, ethical hacking, and vulnerability assessment.**
- **Computer forensics specializations tend to be related to the reason why the data is being recovered.**
- **The main specializations are criminal investigations, in which the expert is tasked with uncovering data that is relevant to a crime, and data recovery**

CYBER SECURITY

- VULNERABILITY ASSESSMENT
- ETHICAL
- ACCESS MANAGEMENT
- SOFTWARE SECURITY
- SYSTEMS ARCHITECTU

IT AUDIT IN BANKING SECTOR

MAJOR OBJECTIVES OF IS AUDIT

- SAFEGUARDING OF INFORMATION SYSTEM ASSETS / RESOURCES
- MAINTENANCE OF DATA INTEGRITY
- MAINTENANCE OF SYSTEM EFFECTIVENESS
- ENSURING SYSTEM EFFICIENCY

SAFEGUARDING OF INFORMATION SYSTEMASSETS / RESOURCES

- SAFEGUARDING OF ASSETS AND RESOURCES OF THE COMPANY WHICH FORMS PART OF THE INFORMATION SYSTEMS SUCH AS HARDWARE, SOFTWARE, TECHNOLOGY ETC.
- ENVIRONMENTCONTROL

MAINTENANCE OF DATA INTEGRITY

- ACCURACY
- CONFIDENTIALITY
- COMPETENCE
- UP-TO-DATE
- RELIABILITY
- AVAILABILITY
- TIMELINESS
- EFFECTIVENESS

MAINTENANCE OF SYSTEM EFFECTIVENESS

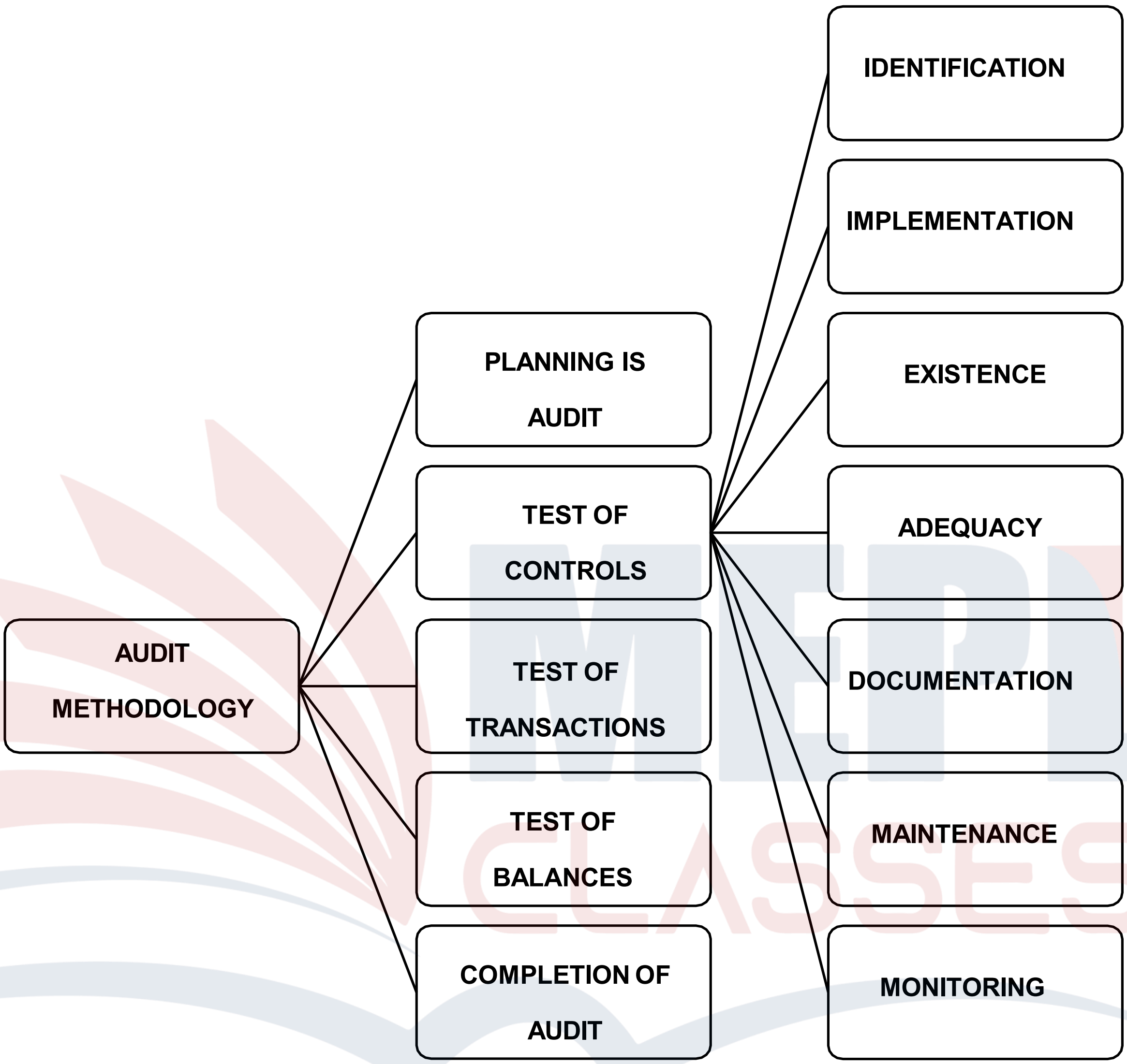
- **Improved Task Accomplishments**
- **Improved Quality**
- **Operational Effectiveness**
- **Technical Effectiveness**
- **Economic Effectiveness**

ENSURING SYSTEM EFFICIENCY

- **SYSTEMS USING MINIMUM RESOURCES TO PRODUCE MAXIMUM OUTPUT**

INFORMATION SYSTEM AUDIT APPROACH

- **AUDITING AROUND THE COMPUTER**
- **AUDITING THROUGH THE COMPUTER**
- **AUDITING WITH THE COMPUTER**



SUB-SYSTEM FACTORING

- **A sub-system is a component of a system that performs some basic functions needed by the overall system to attain its basic objectives. The process of breaking a system into sub-systems is called factoring**

- **Once the system has been factored into several easily understandable subsystems, the task of the IS auditors is:**

- **(a) To evaluate the effectiveness of the controls in each sub-system.**

  (b) To determine the implications of each sub-system's reliability vis-a-vis the overall reliability/effectiveness of the system.

There are two main sets of systems, which require to be further factored into sub-systems for conducting IS

Management Systems

Application Systems

MANAGEMENT SYSTEMS

Can be factored into sub-systems that perform

- **Top-level Management,**
- **Information Systems Management,**
- **Systems Development Management,**
- **Programming Management,**
- **Data Administration,**
- **Quality Assurance Management,**
- **Security Administration, and**
- **Operations Management**

APPLICATION SYSTEMS

They can be broken into sub-systems that perform

- **boundary,**
- **input,**
- **communication,**
- **processing,**
- **database, and**
- **output functions**

BROAD FRAMEWORK FOR CONDUCTING IS AUDIT

- **SAFEGUARDING OF ASSETS**
- **DATA INTEGRITY**
- **BUSINESS CONTINUITY PLANNING**
- **SYSTEM EFFECTIVENESS**
- **SYSTEM EFFICIENCY**
- **ORGANISATION AND ADMINISTRATION**

SAFEGUARDING OF ASSETS

- Environment security
- Uninterrupted Power Supply
- Electrical Lines Data
- Cabling
- Fire Protection
- Insurance
- AMC
- Logical Security Controls

DATA INTEGRITY

- DATA INPUT CONTROL
- DATA PROCESSING CONTROL
- PATCH PROGRAMME
- PARGING OF DATA FILES
- DATA BACKUP
- DATA RESTORATION

BUSINESS CONTINUITY PLANNING

- DISRUPTION TYPES
- RECOVERY TYPES
- BACKUP TYPES
- GIGO (OUTPUT REPORT)
- VIRUS PROTECTION
- VERSION CONTROL

CHAPTER – 14 INTERNAL AUDIT, INTERNAL CONTROL

INTERNAL CONTROL

INTERNAL CONTROL

- CAN BE DEFINED AS A WHOLE SYSTEM OF CONTROL, FINANCIAL OR OTHERWISE ESTABLISHED BY THE ENTITY'S MANAGEMENT
  - INTERNAL CHECK
  - INTERNAL AUDIT
  - OTHER FORMS OF CONTROL
- INTERNAL CONTROL ARE SYSTEMATIC & PRCEDURAL STEPS ADOPTED BY THE ORGANISATION TO MITIGATE RISK PRIMARILY IN AREAS OF FINANCIAL ACCOUNTING & REPORTING, OPERATIONAL PROCESSING & COMPLIANCE WITH LAWS & REGULATIONS.

NOTE:

HENCE INTERNAL CONTROL MEANS THE PROCEDURES ESTABLISHED, IMPLIMENTED & MAINTAINED BY TCWG MANAGEMENT & OTHER PERSONNEL IN ORGANISATION WHICH GIVES REASONABLE ASSURANCE REGARDING ACHEIVEMENT OF ORGANISATION'S OBJECTIVES W.R.T.

- EFFECTIVENESS & EFFICIENCY OF OPERATIONS
- PROTECTION OF ASSETS
- PREVENTION & DETECTION OF FRAUD OR ERROR
- ACCURACY & COMPLETENESS OF FINANCIAL REPORTING
- ADHERENCE TO RELEVANT LAWS

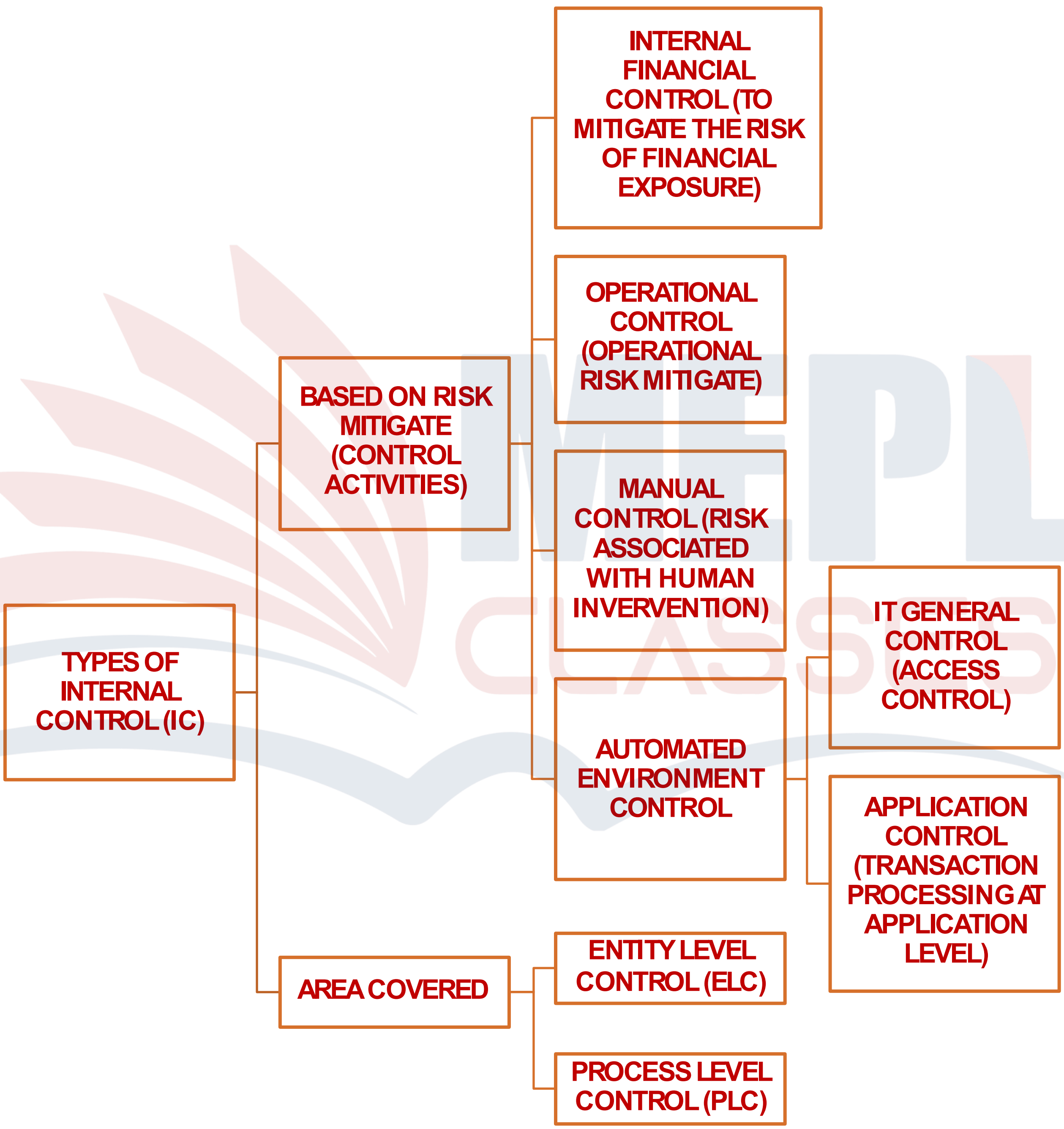
OBJECTIVES OF INTERNAL CONTROL

- **OBJECTIVES OF INTERNAL CONTROL**
  - EXAMINE WHETHER THE TRANSACTIONS ARE EXECUTED AS PER MANAGEMENT POLICIES
  - ACCOUNTING PERIOD OF THE TRANSACTION
  - ASSETS ARE PROTECTED FROM UNAUTHORISED ACCESS
  - COMPARING RECORDED ASSETS WITH EXISTING ONES
  - EVALUATE THE EFFICIENCY OF PERFORMANCE OF ALL THE BUSINESS ACTIVITIES

INTERNAL CONTROL REVIEW METHODS

- NARATIVE METHOD
- CHECKLIST
- QUESTIONNAIRE
- FLOWCHART

TYPES OF INTERNAL CONTROL (IC)



INTERNAL CONTROL PRCEDURES

INTERNAL CONTROL PROCEDURES

- PHYSICAL CONTROL OVER ASSESTS
- AUTHORISATION AND APPROVAL
- SEGREGATION OF DUTIES
- MANAGEMENT DESIGN OF CONTROL
- EFFECTIVE OPERATION CONTROLS

INTERNAL AUDIT

- INTERNAL AUDIT CARRIES OUT THE ASSESSMENT OF INTERNAL CONTROL AND PROVIDES REASONABLE ASSURANCE ON THE EFFECTIVENESS OF THE INTERNAL CONTROL AND THE RISK MANAGEMENT PROCESS
- IT IS AN INDEPENDENT, OBJECTIVE ASSURANCE & CONSULTING ACTIVITY TO ADD VALUE & IMPROVE ORGANISATION'S OPERATIONS. IT HELPS THE ORGANISATION TO ACCOMPLISH ITS OBJECTIVES BY BRINGING A SYSTEMATIC, DISCIPLINED APPROACH TO EVALUATE AND IMPROVE EFFECTIVENESS OF RISK MANAGEMENT, GEVERNMENT IS GOVERNANCE PROCESS.

OBJECTIVE OF INTERNAL AUDIT

- TO CHECK THE AUTHENTICITY & ACCURACY OF ACCOUNTING RECORDS
- STANDARD ACCOUNTING PRACTICES FOLLOWED OR NOT
- EARLY DETECTION & PREVENTION OF FRAUD & ERROR
- TRANSACTIONS ARE RECORDED AFTER PRIOR APPROVAL
- EXPENSES INCURRED ONLY FOR BUSINESS PURPOSES
- TO REVIEW THE ACTIVITIES OF INTERNAL CONTROL

THE COMMITTEE OF SPONSORING ORGANISATION OF THE TREADWAY COMMISSION (COSO)

→INTERNAL CONTROL INTEGRATED FRAMEWORK

FIVE COMPONENTS OF INTERNAL CONTROL

- CONTROL ENVIRONMENT
- RISK ASSESSMENT
- CONTROL ACTIVITIES
- INFORMATION & COMMUNICATION
- MONITORING

AS PER SIA (STANDARD ON INTERNAL AUDIT) 210, ISSUE BY ICAI

↓

INTERNAL AUDIT FUNCTION IS THE RESPONSIBILITY OF THE CHIEF INTERNAL AUDITOR OR DESIGNATED PERSON

ACTIVITIES PERFORMED BY THE INTERNAL AUDITOR

- DEFINE THE OVERALL SCOPE/ PLAN/ METHOD OF THE INTERNAL AUDIT FUNCTION
- OVERSEE & MONITOR VARIOUS AUDIT ASSIGNMENT, THEIR PLANNING, EXECUTION, REPORTING OF FINDING IF ANY RISK
- PLAN/ ENGAGE/ REVIEW OF PERFORMANCE/ TRAINING OF THE STAFF TO ACHIEVE THE OBJECTIVE OF CONTROL ACTIVITIES
- IDENTIFY, SOURCE OR ENGAGE EXTERNAL EXPERTS
- COMMUNICATE & ENGAGE WITH ALL KEY STAKEHOLDERS REGARDING PROGRESS & ACHEIVEMENT OF OBJECTIVES
- DEVELOP & MAINTAIN A QUALITY EVALUATION & IMPROVEMENT PROGRAMME

INTERNAL CONTROL REVIEW OBJECTIVES

INTERNAL CONTROL OBJECTIVES:

A INTERNAL CONTROL OBJECTIVE IS A REASON A CONTROL ACTIVITY IS PUT TO ACTIONS.

- **CATEGORIES OF CONTROL OBJECTIVES**
  - OPERATIONAL (EFFECTIVE & EFFICIENT BUSINESS OPERATIONS)
  - REPORTING [OBJECTIVES PERTAINING TO RELIABLE, TRANSPARENT & TIMELY REPORTING OF FINANCIAL (INTERNAL & EXTERNAL) AND NON-FINANCIAL TRANSACTION]
  - COMPLIANCE (OBJECTIVES RELATING TO FOLLOWING & ABIDING BY THE STATE & FEDERAL LAWS & INDUSTRY REGULATIONS)

OPERATIONAL

(EFFECTIVE & EFFICIENT BUSINESS OPERATIONS)

- **OPERATIONAL (EFFECTIVE & EFFICIENT BUSINESS OPERATIONS)**
  - BUSINESS PERFORMANCE REVIEW
  - PHYSICAL SAFEGUARD & SECURITY OF ASSETS
  - EDUCATION, TRAINING & COACHING
  - REVIEW & APPRAISAL
  - SEGREGATION OF DUTIES

- **REPORTING [OBJECTIVES PERTAINING TO RELIABLE, TRANSPARENT & TIMELY REPORTING OF FINANCIAL (INTERNAL & EXTERNAL) AND NON-FINANCIAL TRANSACTION]**
  - AUTHORISATION
  - REVIEW & APPROVAL
  - VERIFICATION
  - RECONCILIATION
  - PASSWORD PROTECTION
  - SEGREGATION OF DUTIES
  - PERFORMANCE REVIEW

COMPLIANCE (OBJECTIVES RELATING TO FOLLOWING & ABIDING BY THE STATE & FEDERAL LAWS & INDUSTRY REGULATIONS)

- VERIFICATION
- PERFORMANCE REVIEW
- EDUCATION & TRAINING
- POLICIES & PROCEDURE MANUALS

INTERNAL CONTROL AUDIT OBJECTIVES

AUDIT OBJECTIVES ARE DESIGNED TO VERIFY THAT THE PREFFERED OUTCOME OF A CONTROL ACTIVITY IS ACHIEVED

- **JUDGING OF THE CONTROL PROCEDURE AGAINST THE SET PREDEFINED CRITERIA**
  - OCCURRENCE/ EXISTENSE
  - COMPLETENESS
  - ACCURACY
  - CLASSIFICATION
  - CUTOFF/ TIMING
  - REPORTING/ SUMMARY

- **EXAMPLE:**

  INTERNAL CONTROL FOR A PARTICULAR EXPENSES INCURRED BY THE ORGANISATIONS.

- **CONTROL OBJECTIVE:**

  TO PREVENT ANY MISSTATEMENT OR FRAUD IN THE EXPENDITURE.

- **CONTROL ACTIVITY:**

  NO EXPENSE SHALL BE INCURRED WITHOUT APPROVAL OF THE DIRECTOR (I.E. MR. X)

- **AUDIT OBJECTIVES:**

  1. MR. Y – EXPENSES INCURED - 1 LAKH – TRAVELLING
  2. EXISTENCE – MANAGEMENT (MR. X) APPROVE
  3. COMPLETENESS – WRITTEN PROOF (RECORDED)
  4. ACCURACY – ACCURATE AUTHORISATION – EXPENDITURE
  5. CLASSIFICATION – FINANCIAL REPORTING – TRAVELLING/ CONVEYANCE/ PROMOTION/ ADVERTISEMENT
  6. TIMING – EXPENDITURE 2/10 APPRPVAL 2/11
  7. REPORT -

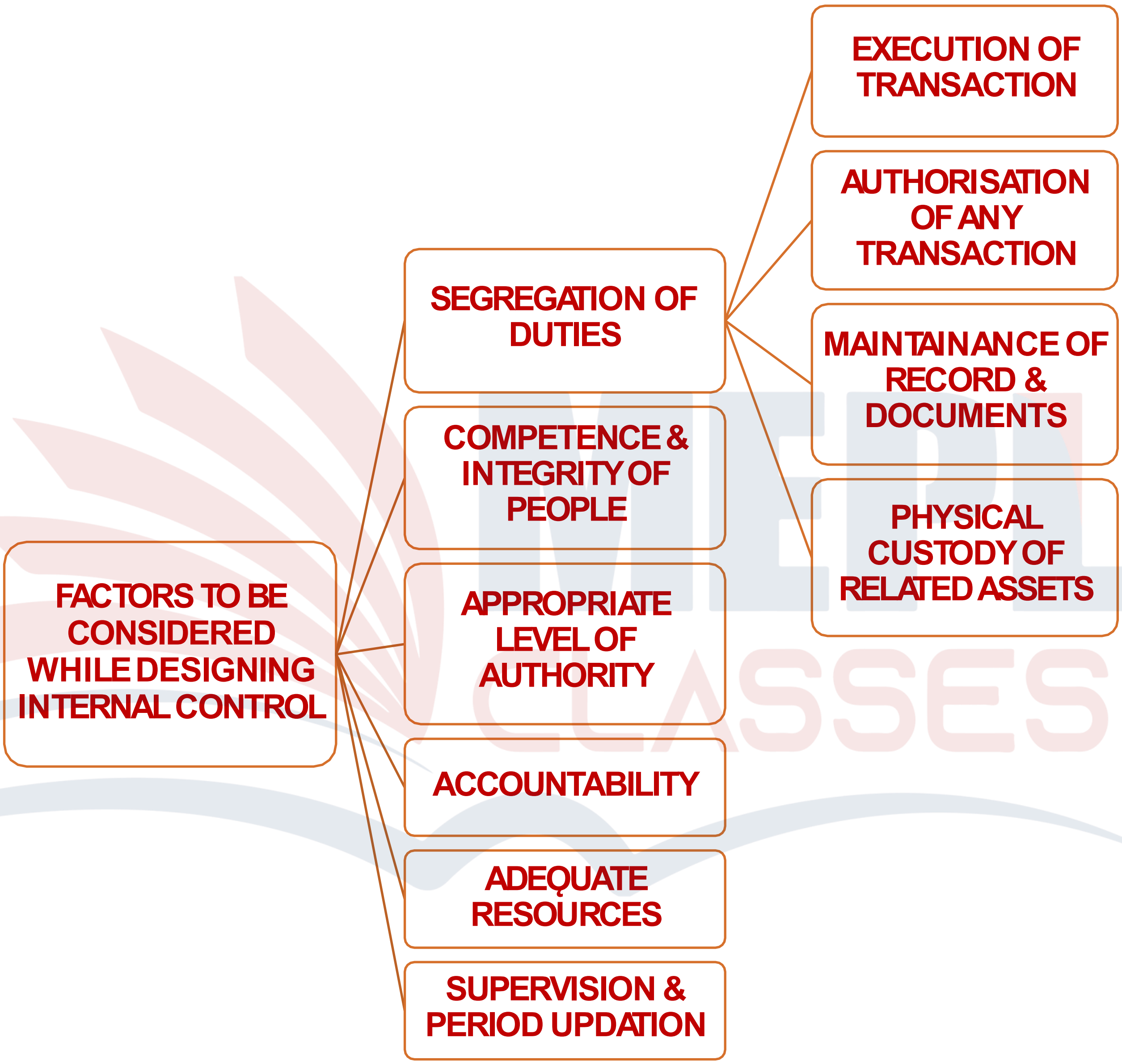
SCOPE OF INTERNAL CONTROL

- **ADMINISTRATIVE CONTROL** – IT INCLUDES ALL THE TYPES OF MANAGERIALCONTROL RELATED TO DECISION MAKING PROCESS. EX. MAINTAINING A REGISTER SHOWING THE DETAILS OF CUSTOMERS CONTACTED BY SALES WAY
- **OPERATIONAL CONTROL** – IT IS EXCERCISED THROUGH MANAGEMENT ACCOUNTING TECHNIQUES SUCH AS BUDGETARY CONTROL & STANDARD COSTING
- **FINANCIAL ACCOUNTING CONTROL** – THESE CONTROL ARE THE MANAGEMENT PLAN RELATING TO SAFEGUARDING OF ASSETS, PREVENTING & DETECTION OF FRAUD/ ERROE, ACCURATE ACCOUNTING RECORDS & TIMELY PREPARATION OF FINANCIAL STATEMENT
- **COMPLIANCE CONTROL** – IT RELATES TO TIMELY COMPLIANCE OF ALL APPLICABLE LAWS & REGULATIONS (STATE OR CENTRAL LAWS ETC.)

STRUCTURE OF INTERNAL CONTROL

INTERNAL CONTROL DIFFERS FROM ORGANISATION TO ORGANISATION & ITS STRUCTURE DEPENDS ON 4 FACTORS:

- TYPE OF BUSINESS
- MAGNITUDE OF BUSINESS
- INFRASTRUCTURE AVAILABLE IN THE ORGANISATION
- POTENTIALITY OF HUMAN RESOURCE


FACTORS TO BE CONSIDERED WHILE DESIGNING INTERNAL CONTROL
SEGREGATION OF DUTIES
EXECUTION OF TRANSACTION
AUTHORISATION OF ANY TRANSACTION
MAINTAINANCE OF RECORD & DOCUMENTS
PHYSICAL CUSTODY OF RELATED ASSETS
COMPETENCE & INTEGRITY OF PEOPLE
APPROPRIATE LEVEL OF AUTHORITY
ACCOUNTABILITY
ADEQUATE RESOURCES
SUPERVISION & PERIOD UPDATION

LIMITATION OF INTERNAL CONTROL

NO MATTER HOW STRONG IC IS BUT IT CAN ONLY PROVIDE A REASONABLE ASSURANCE WITH RESPECT TO ACHEIVEMENT OF ORGANISATIONAL OBJECTIVES & CAN NEVER GIVE ABSOLUTE ASSURANCE DUE TO LIMITATIONS OF IC –

- **COST & BENEFIT ANALYSIS** – MANAGEMENT MAY NOT WANT TO MAKE A STRONG IC DUE TO COST INVOLVED IN IT (COST OF CONTROL & BENEFIT)
- **UNUSUAL TRANSACTION** – NO CONTROL CAN BE MADE FOR UNUSUAL TRANSACTION (BREAKDOWN)
- **HUMAN ERRORS** – THERE IS ALWAYS A CHANCE OF ERROR BEING MADE BY EMPLOYEES HANDLING IC. (JUDGEMENT)
- **ABUSE OF AUTHORITY** – MANAGEMENT MAY OVERRIDE THE IC FOR ITS OWN BENEFIT. (MANAGEMENT OVERRIDE)
- **MANIPULATION BY MANAGEMENT** – MANAGEMENT MAY MANIPULATE THE ACCOUNTING ESTIMATES & JUDGEMENTS. (MULTIPLE CONTROLS)
- **COLLUSION AMONG EMPLOYESS** – EMPLOYEE MAY HAVE EGO CLASHES OR OTHER CONFLICTS WHILE MANAGING INTERNAL CONTROL. (COLLUSION)

EVALUATION OF INTERNAL CONTROL

- **BASIC OBJECTIVES WHILE EVALUATING THE INTERNAL CONTROL**
  - TO SAFEGUARD THE ASSET & CONTROL TRANSACTIONS
  - TO PROVIDE REASONABLE ASSURANCE ON FINANCIAL STATEMENT

- **EVALUATION OF INTERNAL CONTROL**
  - IT MEANS CHECKING THE EFFECTIVENESS OF INTERNAL CONTROL
  - EVALUATION IS MAINLY DONE BY AUDIT COMMITTEE
  - AUDIT COMMITTEE IS APPLICABLE ON COMPANIES U/S 177

FOLLOWING ARE THE COMPANIES REQUIRED TO CONSTITUTE AC (AS PER SEC 177 OF COMPANIES ACT, 2013) – RULE 6 OF MEETING OF BOARD & ITS POWER RULES, 2014

- LISTED COMPANY
- UNLISTED PUBLIC COMPANY (MINIMUM PAID-UP SHARE CAPITAL 10 CR.)
- UNLISTED PUBLIC COMPANY (HAVING TURNOVER MINIMUM 100 CR.)
- UNLISTED PUBLIC COMPANY (HAVING OUTSTANDING LOANS, DEBENTURES, BOROWING & DEPOSITS GREATER THAN 50 CR.)

- THESE LIMITS WILL BE CHECKED BASED ON LAST AUDITED FINANCIAL STATEMENT

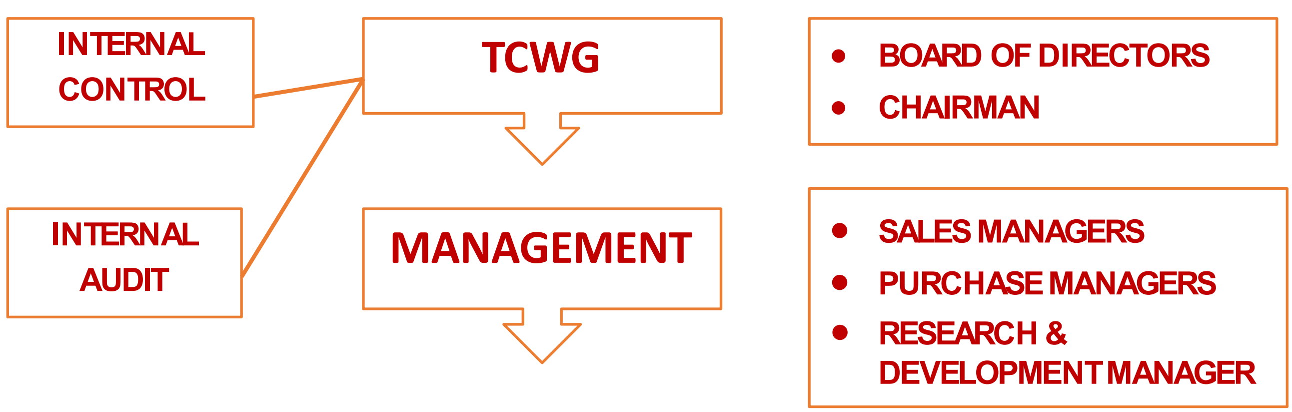
AUDIT COMMITTEE IS NOT APPLICABLE ON THE FOLLOWING UNLISTED PUBIC COMPANY

- WHOLY OWNED SUBSIDIARY (WOS)
- JOINT VENTURE
- DORMENT COMPANY

ROLE & FUNCTIONS OF AUDIT COMMITTEE

- EVALUATION OF INTERNAL FINANCIAL CONTROL & RISK MANAGEMENT SYSTEM
- REVIEW OF THE PERFORMANCE OF BOTH STATUTORY & INTERNAL AUDITOR
- ASKING THE STATUTORY AUDITOR ABOUT ITS COMMENT ON INTERNAL CONTROL
  - CLAUSE XIV OF COMPANY (AUDITOR REPORT) ORDER 2020 (CARO 2020)
    - REQUIRES AN AUDITOR'S REPORT ON ACCOUNT OF THE COMPANY TO INCLUDE A STATEMENT TO WHETHER THERE IS
      - ADEQUATE INTERENAL CONTROL SYSTEM (CONSIDERING THE NATURE & SIZE OF THE BUSINESS)
      - REPORT OF INTERNAL AUDITOR SHOULD BE CONSIDERED FOR THE PERIOD FOR WHICH THE AUDIT IS CONDUCTED
- REVIEW THE FINDING OF THE INVESTIGATION BY THE INTERNAL AUDITOR
- REVIEW OF THE ADEQUACY OF INTERNAL CONTROL & INTERNAL AUDIT FUNCTION
- DISCUSSION WITH THE STATUTORY AUDITOR BEFORE THE AUDIT ABOUT HIS SCOPE OF AUDIT

INTERNAL CONTROL	INTERNAL AUDIT
METHODS & PROCEDURES IMPLEMENTED BY THE MANAGEMENT TO CONROL THE OPERATION FOR ACHEIVEMENT OF ORGANISATIONS OBJECTIVES.	REVIEWS THE EXISTENCE & EFFECTIVENESS OF CONTROLS.
IT INCLUDES INTERNAL AUDIT & INTERNAL CHECK	INTERNAL AUDIT FRACTION ARE DESIGNED BY TCEG TO KEEP A CHECK ON OF MANAGEMENT/ ENTITY.
INTERNAL CONTROL IS CARRIED OUT WHEN THE WORK IS IN PROGRESS	INTERNAL AUDIT IS DONE AFTER THE WORK IS PERFORMED
INTERNAL CONTROL SYSTEM IS TO ENSURE COMPLIANCE WITH THE MANAGEMENT POLICIES.	INTERNAL AUDIT AIMS AT DETECTION OF FRAUD
SCOPE IS WIDER	SCOPE IS NARROW



EMPLOYEE

ROLE OF INTERNAL AUDITOR

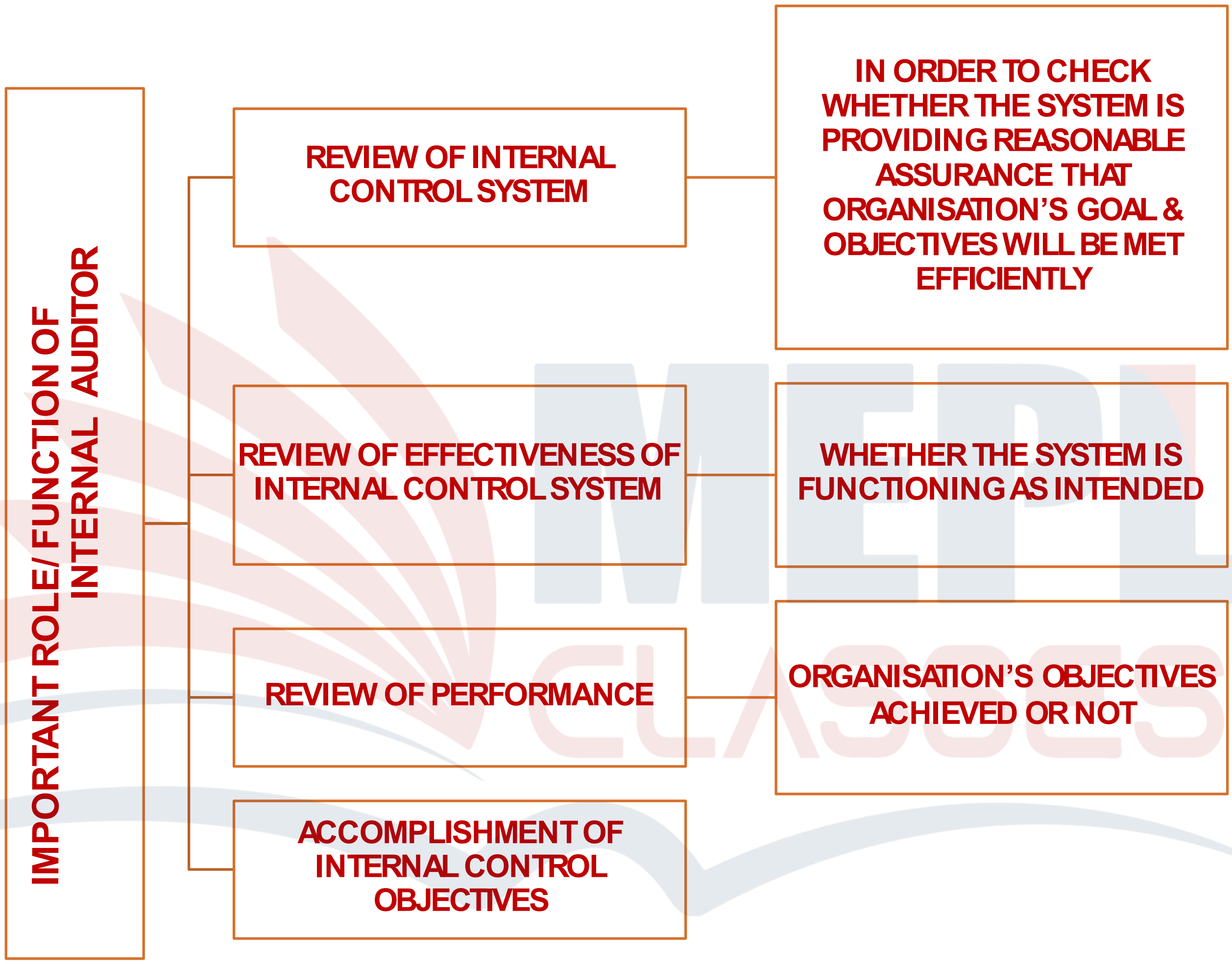
The importance of role of an internal auditor in the context of internal control cannot be exaggerated.

a) The purpose of the review of the systems of internal control is to ascertain whether the system established provides reasonable assurance that the organisation's objectives and goals will be met efficiently and economically.

b) The purpose of the review for effectiveness of the system of internal control is to ascertain whether the system is functioning as intended.

c) The purpose of the review for quality of performance is to ascertain whether the organisation's objectives and goals have been achieved.

d) The primary objectives of internal control are to ensure:
   - reliability and integrity of information.
   - compliance with policies, plans, procedures, laws and regulations.
   - the safeguarding of assets.
   - the economical and efficient use of resources.
   - the accomplishment of established objectives and goals.


IMPORTANT ROLE/ FUNCTION OF INTERNAL AUDITOR
REVIEW OF INTERNAL CONTROL SYSTEM
IN ORDER TO CHECK WHETHER THE SYSTEM IS PROVIDING REASONABLE ASSURANCE THAT ORGANISATION'S GOAL & OBJECTIVES WILL BE MET EFFICIENTLY
REVIEW OF EFFECTIVENESS OF INTERNAL CONTROL SYSTEM
WHETHER THE SYSTEM IS FUNCTIONING AS INTENDED
REVIEW OF PERFORMANCE
ORGANISATION'S OBJECTIVES ACHIEVED OR NOT
ACCOMPLISHMENT OF INTERNAL CONTROL OBJECTIVES

INTERNAL CONTROL & AUDITOR

- THE AUDITOR SHALL IDENTIFY THE DEFICIENCY IN INTERNAL CONTROL ON THE BASIS OF AUDIT WORK PERFORMED
- AUDITOR SHALL ALSO FIND OUT SIGNIFICANT DEFECIENCIES IF ANY IN INTERNAL CONTROL
- ALL SIGNIFICANT DEFECIENCIES SHALL BE REPORTED BY THE AUDITOR TO THE TCWG IN WRITING
- AUDITOR SHALL ALSO REPORT TO THE MANAGEMENT
  - ALL SIGNIFICANT DEFICIENCY
  - OTHER DEFICIENCIES WHICH THE AUDITOR FEELS THAT THE MANAGEMENT SHOULD BE AWARE

WHILE REPORTING THE DEFICIENCIES IN INTERNAL CONTROL TO THE TCWG & MANAGEMENT THE AUDITOR SHALL ALSO COMMUNICATE

- THE AUDITORS OBJECTIVE IS ONLY TO FORM AN OPINION ON THE FINANCIAL STATEMENT
- THE PREPARATION OF INTERNAL CONTROL IS NOT AUDITOR'S RESPONSIBILITY
- DEFICIENCIES IDENTIFIED OR REPORTED ARE LIMITED TO ONLY THOSE WHICH HAVE BEEN IDENTIFIED BY THE AUDITOR

INTERNAL AUDIT NECESSITY/ NEED

- IT ASSIST THE MANAGEMENT TO IMPROVE INTERNAL CONTROL BY IDENTIFYING THE WEAKNESS
- IT HELPS TO DETECT FRAUD & ERRORS
- IT HELPS TO DETECT WASTAGE OF RESOURCES
- IMPROVES OVERALL ORGANISATIONS EFFETIVENESS
- IT INCREASES MORALE OF HONEST STAFF
- HELPS IN CHECKING BOOKS OF ACCOUNTS

INTERNAL AUDITING – EVOLUTION OF THE PROFESSION

CHANAKYA (350-283 BC) WAS AN ADVISOR AND PRIME MINISTER OF FIRST MAURYA EMPEROR CHANDRAGUPTA (340 – 293 BC) IN HIS BOOK 'ARTHASASTRA' MENTIONED ABOUT MAINTENANCE OF ACCOUNTS, PERIODICITY OF ACCOUNTING, VERIFICATION, CERTIFICATION AND VARIOUS AVENUES OF FRAUD (40 TYPES OF EMBEZZLEMENT – CHANAKYA CHALISHA) OF GOVERNMENT FUND /EXCHEQUER.

IN THE MODERN ERA, RAILROAD COMPANIES IN USA ARE OFTEN CREDITED FOR BEING THE FIRST TO INTRODUCE INTERNAL AUDIT DURING THE LATTER PART OF THE NINETEENTH CENTURY. THESE RAILROAD COMPANIES HAD TRAVELING AUDITORS TO VISIT THE RAILROADS' TICKET AGENTS AND DETERMINE THAT ALL THE ACCOUNTING FOR ALL MONIES WAS PROPERLY HANDLED.

THE AUDITORS ARE TO DETERMINE WHETHER LAWS, CONTRACTS, POLICIES AND PROCEDURES HAVE BEEN PROPERLY OBSERVED AND IF ALL BUSINESS TRANSACTIONS WERE CONDUCTED IN ACCORDANCE WITH ESTABLISHED POLICIES AND WITH SUCCESS. IN THIS CONNECTION, THE AUDITORS ARE TO MAKE SUGGESTIONS FOR THE IMPROVEMENT OF EXISTING FACILITIES AND PROCEDURES, CRITICISMS OF CONTRACTS WITH SUGGESTIONS FOR IMPROVEMENT, ETC. THE GROWTH OF LARGE CORPORATE HOUSES DURING THE EARLY PART OF THE TWE NTIETH CENTURY NECESSITATED THE NEED FOR EXTENDED SPAN OF CONTROL BY THE MANAGEMENTS EMPLOYING THOUSANDS OF EMPLOYEES WITH MANUFACTURING PLANTS AT MANY LOCATIONS AND SALES & MARKETING ALL AROUND THE WORLD. THE TRADITIONAL FORM OF AUDIT BY THE PUBLIC ACCOUNTANT WAS NOT VERY EFFECTIVE IN THESE COMPANIES BECAUSE OF HUGE DISTANCES BETWEEN DIFFERENT LOCATIONS BESIDES BEING PROVING VERY COSTLY ALSO AS IT NECESSITATED LOT OF TRAVELING.

THEREFORE, A NEED WAS FELT FOR INTERNAL AUDITORS AT ALL THE LOCATIONS MAINLY FOR PROTECTION OF ASSETS. THE OBJECTIVES OF INTERNAL AUDIT DURING THIS PERIOD HAVE BEEN EXPLAINED AS UNDER:

PROTECTION OF COMPANY ASSETS AND DETECTION OF FRAUD WERE THE PRINCIPAL OBJECTIVES. CONSEQUENTLY, THE AUDITORS CONCENTRATED MOST OF THEIR ATTENTION ON EXAMINATIONS OF FINANCIAL RECORDS

AND ON THE VERIFICATION OF ASSETS THAT WERE MOST EASILY MISAPPROPRIATED. A POPULAR IDEA AMONG MANAGEMENT PEOPLE A GENERATION AGO WAS THAT THE MAIN PURPOSE OF AN AUDITING PROGRAM WAS TO SERVE AS A PSYCHOLOGICAL DETERRENT AGAINST WRONGDOING BY OTHER EMPLOYEES.

HOWEVER, THIS ROLE OF INTERNAL AUDITOR HAS UNDERGONE A VAST CHANGE DURING THE SECOND HALF OF TWENTY FIRST CENTURY. EARLIER, INTERNAL AUDITING WAS ESSENTIALLY TO CHECK THE RECORDS AFTER THOSE HAD BEEN CREATED TO ENSURE ACCURACY. THESE INTERNAL AUDITORS WERE ALSO CONCERNED WITH THE POSSIBILITY OF FRAUD.

THE EMERGENCE OF WAR ECONOMY DURING 1940S IS ATTRIBUTED CREDIT FOR THE INITIAL EXPANSION IN SCOPE OF INTERNAL AUDIT. WITH HUGE BACK-LOG OF ORDERS, MANAGEMENTS BECAME MORE CONCERNED WITH PRODUCTION SCHEDULING, SHORTAGES OF MATERIALS AND LABOURERS, AND COMPLIANCE WITH REGULATIONS. MOST OF THESE CONTRACTS WERE ON COST PLUS BASIS. THEREFORE, COST REPORTING ALSO BECAME MORE IMPORTANT. AS A RESULT, INTERNAL AUDITORS BEGAN DIRECTING THEIR EFFORTS TOWARDS OTHER AREAS ALSO, WHICH WERE TILL THEN OUTSIDE THE PURVIEW OF INTERNAL AUDIT.

SECTION 301 (PUBLIC COMPANY AUDIT COMMITTEE) OF THE SARBANES-OXLEY ACT PASSED BY THE U.S. CONGRESS IN THE YEAR 2002 REQUIRES AN AUDIT COMMITTEE IN ALL THE LISTED COMPANIES. SECTION 404 (MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS) OF THE SAID ACT REQUIRES AN ANNUAL REPORT ON MANAGEMENT OF THE INTERNAL CONTROLS AND THEIR EFFECTIVENESS. THE LAW REQUIRES ANNUAL REPORTS TO CONTAIN AN ASSESSMENT OF THE EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING.

INTERNAL AUDIT EVOLUTION

- **HISTORICAL PERIOD**
  - CHANAKYA (ADVISOR OF CHANDRAGUPTA MAURYA)
  - ARTHASASTRYA (40 TYPES OF EMBEZZLEMENT)
    - IT HIGHLIGHTED BASIC PRINCIPLES OF ACCOUNTING, VERIFICATION & FRAUD DETECTION
- **EARLY 90'S**
  - SCOPE OF INTERNAL AUDIT INCLUDES INSPECTION OF TRANSACTION & IT'S ACCOUNTING. FURTHER IT INCLUDED PROTECTION OF ASSETS & DETECTION OF FRAUD
- **LATE 90'S**
  - SCOPE WAS EXPANDED TO INCLUDE A CHECK ON OPERATIONS SUCH AS MATERIAL MANAGEMENT, LABOUR MANAGEMENT, PERFORMANCE OF ENTITY (AUDIT OF OPERATIONS)

SARBANES-OXLEY ACT (US) 2002

- **SCETION 301**
  - AUDIT COMMITTEE FOR ALL LISTED COMPANY
- **SECTION 404**
  - ANNUAL REPORT A STATEMENT OF EFFECTIVENESS OF INTERNAL CONTROL

INTERNAL AUDIT UNDER THE COMPANY'S ACT (2013)

- APPLICABIITY (SEC 138 READ WITH RULE 13 OF THE COMPANIES (ACCOUNTS) RULE, 2014
  - LISTED COMPANY
  - UNLISTED PUBLIC COMPANY SATISFYING ANY ONE OF THE FOUR CONDITIONS
    - PUBLIC DEPOSITS OUTSTANDING MINIMUM 25 CRORES
    - PAID-UP SHARE CAPITAL MINIMUM 50 CRORES
    - LOAN/ BORROWING OUTSTANDING FROM BANK/ PUBLIC FINANCIAL INSTITUTION GREATER THAN 100 CRORES
    - TURNOVER MINIMUM 200 CRORES
  - PRIVATE COMPANY SATISFYING ONE OF THE TWO CONDITIONS
    - LOAN/ BORROWINGS OUTSTANDING FROM BANKS/ PUBLIC FINANCIAL INSTITUTION GREATER THAN 100 CRORES
    - TURNOVER MINIMUM 200 CRORES

INTERNAL AUDIT UNDER THE COMPANY'S ACT (2013)

- LIMIT SHALL BE CONSIDERED OF IMMEDIATELY PRECEEDINGS FINANCIAL YEAR

NOTE: IF COMPANY FAILS TO APPOINT INTERNAL AUDITOR

- **COMPANY**
  - UPTO 10,000
    1000 PER DAY
- **EVERY OFFICER IN DEFAULT**
  - UPTO 10,000
    1000 PER DAY

INTERNAL AUDITOR

- ELIGIBILITY: CA OR CMA OR ANY OTHER PROFESSIONAL (CS) INTENAL AUDITOR MAY OR MAY NOT BE AN EMPLOYEE (STATUTORY AUDITOR CAN NOT BE APPOINTED AS INTENAL AUDITOR)
- APPOINTING AUTHORITY: BOARD OF DIRECTOR SHALL APPOINT INTENAL AUDITOR IN CONSULTATION WITH AUDIT COMMITTEE
- FORM NO: MGT 14 HAS TO BE SUBMITTED TO INFORM ROC WITHIN 30 DAYS OF APPOINTMENT.
- DUTIES & SCOPE: NOT MENTIONED IN ACT SO IT WILL BE AS PER THE TERMS OF ENGAGEMENT
  - AS PER RULE 13(2): AUDIT COMMITTEE/ BOARD OF DIRECTOR IN CONSULTATION WITH THE INTERNAL AUDITOR FORMULATE THE SCOPE, FUNCTIONING, PERIODICITY & METHODOLOGY FOR CONDUCTING INTERNAL AUDIT
- PENAL PROVISION: NO SPECIFIC PROVISION EXISTS

Sum Up

Internal control is the process, effected by an entity's Board of Trustees, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Reliability of financial reporting,
- Effectiveness and efficiency of operations, and
- Compliance with applicable laws and regulations.

Types of Internal Controls

- **Detective:** Designed to detect errors or irregularities that may have occurred.
- **Corrective:** Designed to correct errors or irregularities that have been detected.
- **Preventive:** Designed to keep errors or irregularities from occurring in the first place.

5 ELEMENTS OF INTERNAL CONTROL

CONTROL ENVIRONMENT

- I – INTEGRITY & ETHICAL VALUES
- C – COMMITMENT TO COMPETANCE
- H – HUMAN RESOURCE POLICIES & PRACTICES
- A – ASSIGNMENT OF AUTHORITY & RESPONSIBILITY
- M – MANAGEMENT PHILOSOPHY & OPERATING STYLE
- B – BOARD OF DIRECTORS OR AUDIT COMMITTEE PARTICIPATION
- O – ORGANISATION'S STRUCTURE
- ICHAMPBO

RISK ASSESSMENT

- CHANGES IN OPERATING ENVIRONMENT
- NEW PERSONNAL
- NEW INFORMATION SYSTEM
- RAPID GROWTH
- NEW TECHNOLOGY
- CORPORTE RESTRUCTURING

CONTOL ACTIVITIES (PIPS)

- P – PERFORMANCE REVIEW
- I – INFORMATION PROCESSING
- P – PHYSICAL CONTROL
- S – SEGREGATION OF DUTIES

INFORMATION & COMMUNICATION

- IDENTIFY & RECORD ALL VALID TRANSACTIONS
- DESCRIBE ON TIMELY BASIS
- MEASURE THE VALUE PROPERLY
- RECORD IN PROPER TIME PERIOD
- PROPERLY PRESENT & DISCLOSE
- COMMUNICATE RESPONSIBILITIES TO EMPLOYEES

MONITORING

- ASSESSMENT OF QUALITY OF INTERNAL CONTROL PERFORMANECE OVER TIME

WHEN INTERNAL CONTROL ARE WEAK OR NOT IN EXISTENCE

- **COMPENSATING CONTROLS**
  - COMPENSATING CONTROLS CAN BE IMPLEMENTED IN SITUATIONS WHERE ONE PERSON HAS TO DO ALL OF THE BUSINESS-RELATED TRANSACTIONS FOR A DEPARTMENT.
- **COST BENEFIT ANALYSIS OF A CONTROL SHOULD ALSO CONSIDER THE COST OF FRAUD**
  - IF IMPLEMENTING A RECOMMENDED CONTROL SEEMS TOO EXPENSIVE, BE SURE TO CONSIDER THE COST OF A FRAUD THAT COULD OCCUR BECAUSE OF THE MISSING CONTROL. FRAUD IS ALWAYS EXPENSIVE AND THE PREVENTION OF FRAUD IS WORTH THE COST.
- **CONSIDER THE ISSUE OF TRUST**
  - THE ADMINISTRATOR SHOULD REMAIN OBJECTIVE (FINALLY CONSIDER THE ISSUE OF TRUST. MOST EMPLOYEES ARE TRUSTWORTHY AND RESPONSIBLE, WHICH IS AN IMPORTANT FACTOR IN EMPLOYEE RELATIONS AND DEPARTMENTAL OPERATIONS. HOWEVER, IT IS ALSO THE RESPONSIBILITY OF ADMINISTRATORS TO REMAIN OBJECTIVE. EXPERIENCE SHOWS THAT IT IS OFTEN THE MOST TRUSTED EMPLOYEES WHO ARE INVOLVED IN COMMITTING FRAUDS.)

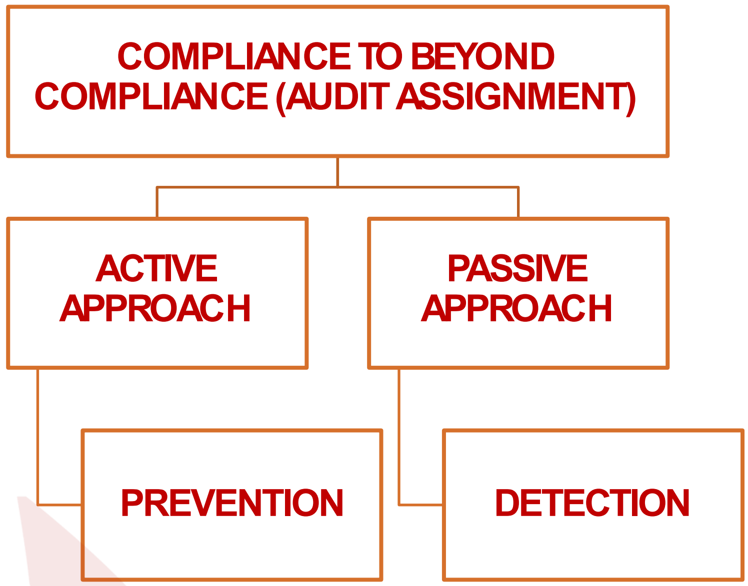
CHAPTER – 15 Operational Audit and Internal Audit under Companies Act, 2013

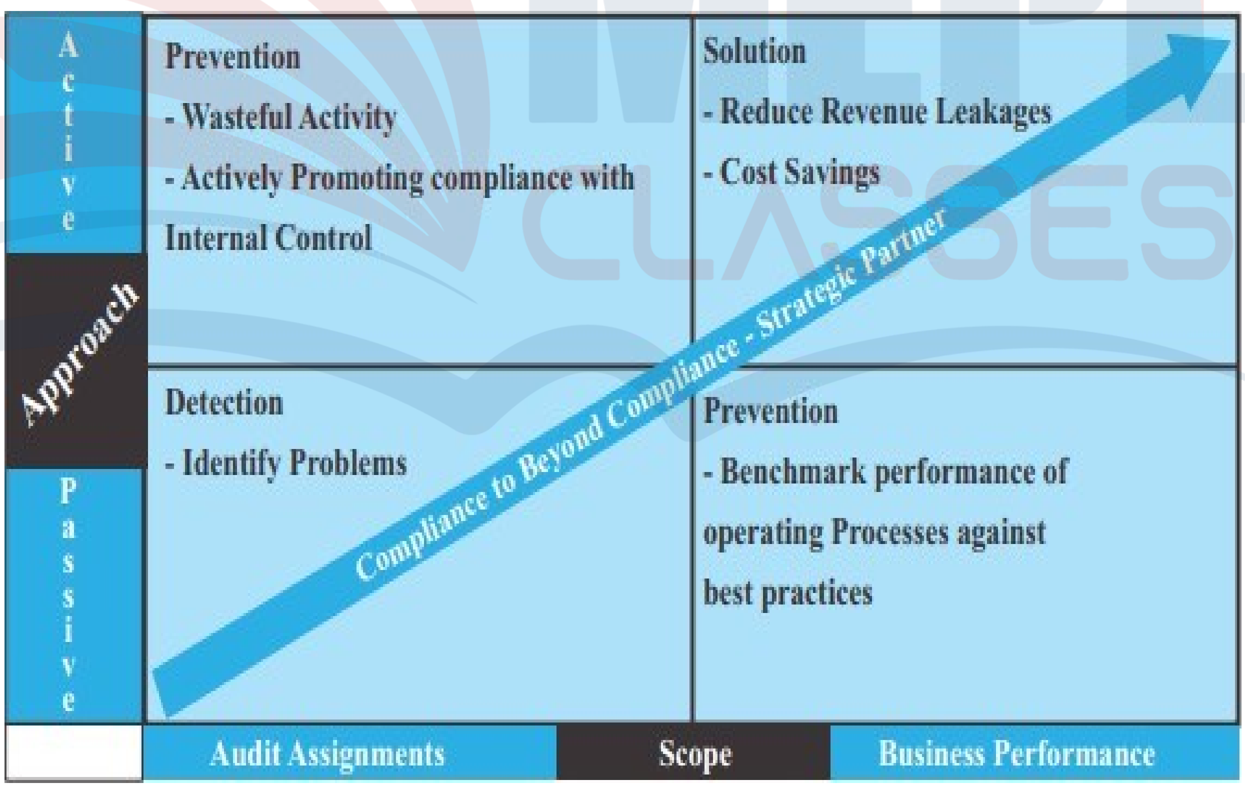
OPERATIONAL AUDIT

"OPERATIONAL AUDIT" IS AUDITING WHICH GOES BEYOND FINANCIAL TRANSACTION AND ACCOUNTING RECORD AND EXAMINES INTO THE OPERATING, MANAGERIAL OR ADMINISTRATIVE PERFORMANCE OF THE ENTITY.

- RESIDUARY APPROACH → INTERNAL AUDIT/ STATUTORY AUDIT END OF FINANCIAL YEAR 31/03/23.
- FINANCIAL STATEMENT → BALANCE SHEET & PROFIT & LOSS → STATUTORY AUDITOR.
- INTERNAL CONTROL & INTERNAL AUDIT → INTERNAL AUDITOR.

PREPARATION OF AUDIT:


COMPLIANCE TO BEYOND COMPLIANCE (AUDIT ASSIGNMENT)
ACTIVE APPROACH
PASSIVE APPROACH
PREVENTION
DETECTION


Active
Approach
Passive
Prevention
- Wasteful Activity
- Actively Promoting compliance with Internal Control
Solution
- Reduce Revenue Leakages
- Cost Savings
Detection
- Identify Problems
Prevention
- Benchmark performance of operating Processes against best practices
Compliance to Beyond Compliance - Strategic Partner
Audit Assignments
Scope
Business Performance

- ACTIVE APPROACH → PREVENTION
- PASSIVE APPROACH → DETECTION
- COMPLIANCE TO BEYOND COMPLIANCE (INTERNAL CONTROL COMPLIANCE).
- RISK BASED APPROACH → RISK RELATED TO "OPERATION"

OPERATION AUDIT OBJECTIVES

TQM (TOTAL QUALITY MANAGEMENT) TERM WAS DEFINED BY W.E. DEMING

↔ **OPERATION AUDIT OBJECTIVES**

- D – DETAILED UNDERSTANDING OF EXISTING PROCESS.
- E – ELIMINATE WASTE, DUPLICATION OF WORK.
- M – MERGE OPERATION TO REDUCE TURNAROUND TIME.
- I – IMPROVE/ INCREASE QUALITY, VOLUME, REVENUE.
- N – NEW METHODS, TECHNIQUE, DEVICES FOR BETTER EXPERIENCE.
- G – GOVERN MEN, MACHINE, METHODS & MONEY

ADVANTAGES & DISADVANTAGES OF OPERATIONAL AUDIT

ADVANTAGES	DISADVANTAGES
REDUCING TURN AROUND TIME	RESISTANCE TO EXCHANGE (THE MANAGEMENT/ ENTITIES/ OWNER IS NOT ACCEPTING THE CHANGE)
PROCESS INEFFICIENCIES	
COST REDUCTION	
OPERATIONAL EXCELLENCE	

STEPS OF OPERATIONAL AUDIT

1. DEFINE THE SCOPE OF AUDIT WORK
2. OBTAIN THE KNOWLEDGE OF CLIENT BUSINESS
3. EVALUATE ACCOUNTING SYSTEM & INTERNAL CONTROL SYSTEM
4. DETERMINE THE NATURE, TIMING & EXTENT OF AUDIT PROCEDURES TO BE PERFORMED
5. ADEQUATE DOCUMENTATION IS NECESSARY
6. FORM AN OPINION
7. ISSUE AN AUDIT REPORT

AUDIT TECHNIQUES FOR EVIDENCE

- ELECTRONICAL DATA PROCESSING FOR GAP ANALYSIS
- PROCESS FLOW CHARTING
- DISCUSSION WITH TCWS/ MANAGEMENT/ EMPLOYEE FOR CLARITY

AUDIT PROGRAMME

IT IS A DETAILED LAYOUT OF AUDIT PLAN WHICH CONTAINS EXACT AUDIT PROCEDURES TO BE APPLIED ON EXACT DATE ON EXACT ITEM OF FINANCIAL STATEMENT BY EXACT AUDITING STAFF.

ADVANTAGE OF AUDIT PROGRAMME

- IT IS A READY CHECKLIST OF AUDIT PROCEDURES THAT HAS BEEN APPLIED.
- WORK CAN BE ALLOCATED TO AUDIT TEAM EASILY
- AUDIT IS TIMELY COMPLETED
- AUDIT PLAN IS ACHIEVED
- AUDIT EVIDENCES CAN BE EASILY COLLECTED
- IT MAKES AUDIT MORE EFFECTIVE

DISADVANTAGE OF AUDIT PROGRAMME

- UNUSUAL OR NEW AREAS MIGHT GET NEGLECTED
- AUDIT BECOMES MECHANICAL
- AUDIT BECOMES RIGID
- IT KILLS THE INITIATIVE OF EFFICIENT STAFF

CONTINUOUS AUDIT	FINAL AUDIT
IT IS A TYPE OF AUDIT WHICH STARTS BEFORE THE END OF FINANCIAL YEAR	IT IS A TYPE OF AUDIT WHICH IS DONE AFTER THE END OF FINANCIAL YEAR.
IT IS DONE THROUGHOUT THE FINANCIAL YEAR OR MAY BE MONTHLY	NOT DONE THROUGHOUT
IT IS SUITABLE FOR ORGANISATION HAVING LARGE VOLUME OF TRANSACTIONS OR WHERE INTERNAL CONTROL IS WEAK.	SUITABLE FOR ORGANISATION HAVING LESS VOLUME OF TRANSACTIONS OR WHERE INTERNAL CONTROL IS STRONG.

AUDIT WORKING PAPER	
	AUDIT WORKING PAPERS MEANS AUDIT FILE CONTAINING AUDIT PROCEDURES APPLIED, AUDIT

DEFINITION	EVIDENCE COLLECTED & AUDITOR'S OBSERVATIONS.
ADVANTAGES	1. IT HELPS IN AUDIT PLANNING 2. HELPS IN FUTURE REFERENCE OF ARTICLES & ASSISTANCE 3. ACTS AS A LEGAL EVIDENCE THAT AUDIT WAS CONDUCTED PROPERLY

FORMS OF WORKING PAPER DEPENDS UPON THE FOLLOWING FACTOR

- SIZE OF THE ORGANISATION
- NATURE OF ORGANISATION
- COMPLEXITY
- RELIANCE PLACED ON INTERNAL CONTROL
- TYPE OF AUDIT PROCEDURES APPLIED
- RISK OF MATERIAL MISSTATEMENT

TYPES OF WORKING PAPERS

PERMANENT AUDIT FILES	CURRENT AUDIT FILES
IT RECORD THOSE NON-RECURRING AUDIT MATTERS WHICH DO NOT CHANGE YEAR AFTER YEAR: **CONTENTS ARE AS FOLLOWS:** ❑ LEGAL & ORGANISATION STRUCTURE OF THE ENTITY (MEMORANDUM OF ASSOCIATION/ ARTICLES OF ASSOCIATION) ❑ EXTRACT OR COPIES OF LEGAL DOCUMENT, AGREEMENT AND MINUTES RELEVANT FOR AUDIT ❑ A RECORD OF STUDY & EVALUTION OF INTERNAL CONTROL ❑ SIGNIFICANT RATIOS & TREND ❑ COPIES OF PREVIOUS YEAR FINANCIAL STATEMENT (BALANCE SHEET/ PROFIT & LOSS ETC.)	IT RECORD THOSE RECURRING AUDIT MATTERS WHICH GENERALLY CHANGE YEAR AFTER YEAR: ❑ CORRESPONDENCE RELATING TO ACCEPTANCE OF ANNUAL REAPPOINTMENT ❑ EXTRACTS OF MINUTES OF BOARD MEETING & GENERAL MEETING ❑ COPIES OF MANAGEMENT LETTER ❑ ANALYSIS OF TRANSACTIONS & BALANCES ❑ COPIES OF COMMUNICATION WITH MANAGEMENT, AUDITORS, EXPERTS, THIRD PARTY ETC. ❑ AUDIT PROGRAMME

❑ NOTES REGARDING SIGNIFICANT ACCOUNTING POLICIES ❑ SIGNIFICANT AUDIT OBSERVATIONS OF PREVIOUS YEAR.	❑ CONCLUSION OF SIGNIFICANT AUDIT ASPECT

NOTE:

WHATEVER OBSERVATION IS MADE ON CURRENT YEAR BY THE AUDITOR WHICH WAS A PART OF CURRENT FILE FOR THE YEAR, WILL BE TREATED AS CONTENT OF PERMANENT AUDIT FILE IN NEXT YEAR ONWARDS

AUDIT NOTEBOOK

MEANING	IT IS A BOUND BOOK WHICH CONTAINS LARGE VARIETY OF AUDIT MATTERS OBSERVED DURING THE COURSE OF AUDIT
CONTENT	❖ NAME OF THE BUSINESS ENTITY ❖ ORGANISATIONAL STRUCTURE ❖ IMPORTANT PROVISIONS OF MEMORANDUM OF ASSOCIATION & ARTICLES OF ASSOCIATION ❖ COMMUNICATION WITH PERVIOUS AUDITOR ❖ MANAGEMENT REPRESENTATION & INSTRUCTION ❖ LIST OF BOOKS OF ACCOUNTS MAINTAINED

	❖ ACCOUNTING METHODS, INTERNAL CONTROL SYSTEM, APPLICABLE LAW ❖ KEY MANAGERIAL PERSONS ❖ ERRORS & FRAUDS ❖ MATTERS REQUIRED EXPLANATION OR CLARIFICATION ❖ SPECIFIC POINTS FOR SUBSEQUENT AUDIT

Specimen of Audit Note Book

M/s. XYZ Private Limited Audit Notes for the Financial Year

Voucher/ Reference No.	Account Involved	Amount	Query/ Remarks	How disposed of
21	Machinery	2,000	Amount wrongly capitalized	Rectified after consulting with Mr. A, Chief Accountant
64	P.F.	1,750	Late deposited	Clarified with Mr. B from HR
80	Advertisement	5,000	MD sanction required	Sanction obtained
150	Colonel Securities	40,000	No TDS	TDS deducted and deposited with interest
167	Rent	2,000	Receipt required	Receipt obtained

SPECIMEN

VOUCHER/ REFERENCE NO.	AMOUNT	ACCOUNT INVOLVED	OBSERVATION	SOLUTION
10	1000	PLANT & MACHINERY	WRONGLY CAPITALISED	RECTIFIED AFTER DISCUSSION WITH MANAGEMENT

ENGAGEMENT LETTER

MEANING	IT'S A LETTER WHICH IS SENT BY THE AUDITOR TO THE CLIENT BEFORE ACCEPTING THE AUDIT. LETTER COMPANY CLIENT
CONTENT	❑ AUDITOR'S SCOPE OF AUDIT ❑ AUDITOR'S RESPONSIBILITY ❑ MANAGEMENT RESPONSIBILITY ❑ AUDITOR'S UNRESTRICTED ACCESS TO BOOKS OF ACCOUNTS.

TERMS OF AUDIT ENGAGEMENT

- **AGREEING THE TERMS & CONDITION OF THE ENGAGEMENT WITH CLIENT**
- **AUDITOR'S RESPONSES TO THE REQUEST BY A CLIENT TO CHANGE THE TERM OF AN ENGAGEMENT TO ONE THAT PROVIDES A LOWER LEVEL OF ASSURANCE**

AUDITOR ⟷ **ENGAGEMENT LEETER** ⟷ **CLIENT/ MANAGEMENT**

↓

<u>TERMS OF ENGAGEMENT</u>

- ❑ AUDITOR'S SCOPE
- ❑ AUDITOR'S RESPONSIBILITY
- ❑ MANAGEMENT RESPONSIBILITY
- ❑ UNRESTRICTED ACCESS TO BOOKS OF ACCOUNTS

Specimen Internal Audit Engagement Letter

[DATE]

[NAME, TITLE] [DEPARTMENT] [ADDRESS]

[CITY, STATE PIN]

Dear [HEAD OF DEPARTMENT]

The Internal Audit Team is planning its audit for [DEPARTMENT NAME], The objectives of this audit will be: [LIST ACTUAL OBJECTIVES HERE]

For example:

- Reliability and Integrity of Financial and Operational Information,
- Compliance with Laws, Regulations, and Contracts,
- Safeguarding of Assets, and
- Effectiveness and Efficiency of Operations of the [AUDIT AREA], and
- To follow-up on recommendations included in prior audit reports. The proposed timetable for this year's audit is as follows:
- Start date in the field: [DATE]
- Estimated weeks to complete: [NUMBER OF WEEKS] The audit team will include the following members:

[NAME], Manager [NAME], Staff Auditor [NAME], Staff Auditor

Specimen Internal Audit Engagement Letter

[DATE]

At the beginning of our audit, we would like the opportunity to meet with you to discuss our audit objectives and solicit your input. Our goal is to perform an effective and efficient audit. We will need your staff to provide us the following documents and schedules on:

1. [DOCUMENTS] and [DATE]
2. [DOCUMENTS] and [DATE]

At the conclusion of our audit, we will discuss audit results and potential recommendations with management of the audited area before scheduling an exit conference with you. Prior to the exit conference, you will receive a draft audit report. After the exit conference, a final audit report will be delivered to you with a request for formal management's responses to include in the audit report.

Our mission is to help you achieve [DEPARTMENTS] objectives by providing you information about the effectiveness of internal control and by recommending courses of actions which improve performance. If you have any questions about this year's audit, please do not Hesitate to call.

Yours truly,

[XYZ] [Designation]

AUDIT SPECIMEN

LETTER HEAD OF INTERNAL AUDITOR

[DATE]

MR. X, R & D DEPARTMENT

[ADDRESS]

[CITY, STATE, PIN]

DEAR (HOD)

1. THE INTERNAL AUDIT TEAM IS PLANNING THE AUDIT FOR R & D DEPARTMENT. THE OBJECTIVES WILL BE

   INTERNAL AUDIT OBJECTIVES

   START DATE

   END DATE

2. THE AUDIT TEAM WILL BE AS FOLLOWS
   - ✓ .
   - ✓ .
   - ✓ .
3. PURPOSE OF INTERNAL AUDIT
4. FOLLOWING BOOKS/ DOCUMENT SHOULD BE AVAILABLE AT THE TIME OF AUDIT
   - ✓ .
   - ✓ .

YOUR TRULY

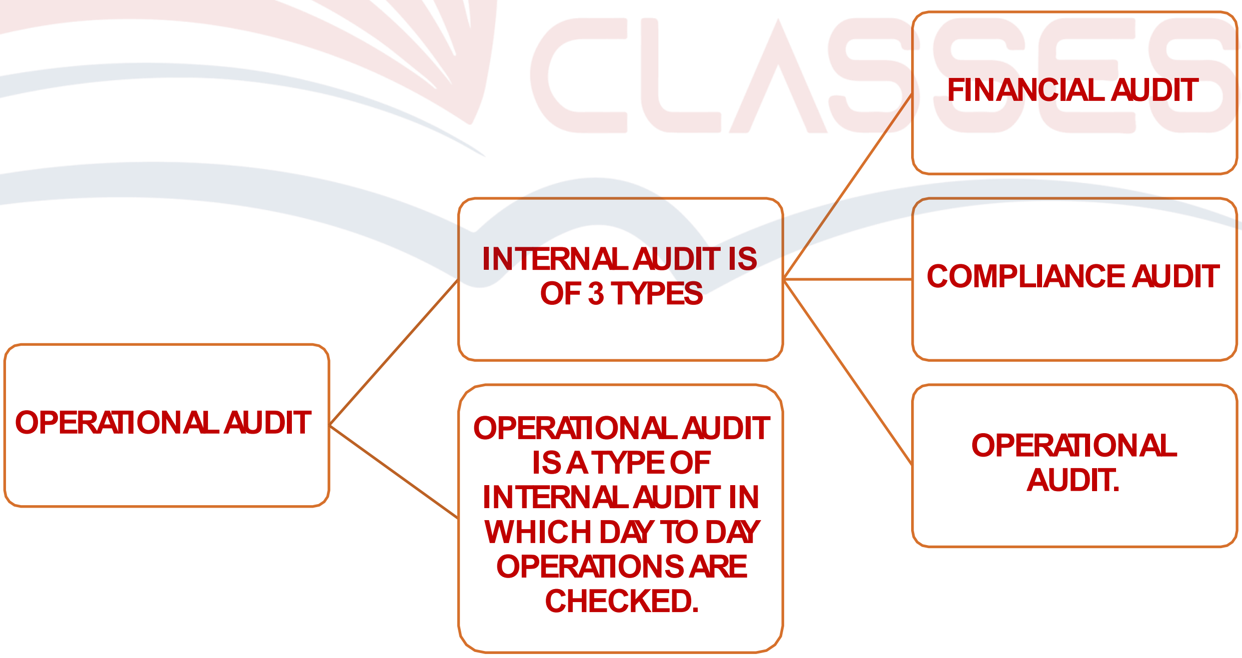
[Designation]

[COMPANY NAME] [STAMP] [SIGN]

ROLE OF CMA IN AUDIT

(SAME AS INTERNAL AUDIT NECESSITY & INTERNAL AUDIT EVOLUTION)

- The Enterprise Risk Management is emerging as the key element in Corporate Management.
- The role of effective Cost Management involves in waste reduction and enhancing productivity and process improvement.
- The Internal Audit must be synchronized to the expectations of the Board.
- CMAs can apply their forward-looking insights across the organisation to manage risks, reduce costs and create new opportunities, preserve and enhance value.



DIFFERENCE BETWEEN INTERNAL AUDIT & OPERATIONAL AUDIT

INTERNAL AUDIT	OPERATIONAL AUDIT
1. COMPLIANCE OBJECTIVE	RISK IDENTIFICATION, PROCESS IMPROVEMENT OBJECTIVE
2. FINANCIAL ACCOUNTS FOCUS	BUSINESS FOCUS
3. AUDIT FOCUS	EFFICIENCY & IMPROVEMENT FOCUS
4. TRANSACTION-BASED	PROCESS-BASED
5. POLICIES AND PROCEDURES FOCUS	RISK MANAGEMENT FOCUS
6. COST CENTRE WISE BUDGET MONITORING	ACCOUNTABILITY FOR PERFORMANCE IMPROVEMENT RESULTS
7. METHODOLOGY: FOCUS ON POLICIES, TRANSACTIONS AND COMPLIANCE	METHODOLOGY: FOCUS ON GOALS, STRATEGIES AND RISK MANAGEMENT PROCESSES

OPERATIONAL AUDIT

THE COMMITTEE OF SPONSORING ORGANIZATIONS OF THE TREADWAY

COMMISSION (COSO) HAD RECENTLY ISSUED THE "COSO REPORT", WHICH WAS JOINTLY SPONSORED BY THE INSTITUTE OF INTERNAL AUDITORS (IIA), THE AMERICAN INSTITUTE OF CPAS, THE FINANCIAL EXECUTIVES INSTITUTE, THE AMERICAN ACCOUNTING ASSOCIATION, AND THE INSTITUTE OF MANAGEMENT TO PROVIDE A COMMON, WIDELY ACCEPTED DEFINITION OF INTERNAL CONTROL AND PROVIDE A FRAMEWORK OF INTERNAL CONTROL WHICH CAN BE USED AS A BENCHMARK FOR ASSESSING ITS EFFECTIVENESS. THE COSO REPORT DEFINES INTERNAL CONTROL AS FOLLOWS: …

A PROCESS, EFFECTED BY AN ENTITY'S BOARD OF DIRECTORS, MANAGEMENT AND OTHER PERSONNEL, WHICH IS DESIGNED TO PROVIDE REASONABLE ASSURANCE REGARDING THE ACHIEVEMENT OF OBJECTIVES IN ONE OR MORE CATEGORIES:

- EFFECTIVENESS AND EFFICIENCY OF OPERATIONS.
- RELIABILITY OF FINANCIAL INFORMATION.
- COMPLIANCE WITH APPLICABLE LAWS AND REGULATIONS.

INTERNAL AUDIT UNDER COMPANIES ACT, 2013 [U/S 138]

COMPULSORY REQUIREMENT FOR APPOINTMENT OF INTERNAL AUDITOR(S) IN LISTED AND SPECIFIED COMPANIES

SECTION 138 READ WITH RULE 13 OF THE COMPANIES (ACCOUNTS) RULES, 2014 PROVIDE THAT FOLLOWING CLASS OF COMPANIES SHALL BE

REQUIRED TO APPOINT AN INTERNAL AUDITOR OR A FIRM OF INTERNAL AUDITOR; NAMELY:

a) EVERY LISTED COMPANY

b) EVERY UNLISTED PUBLIC COMPANY HAVING:

1. PAID UP SHARE CAPITAL OF 50 CRORE RUPEES OR MORE DURING THE PRECEDING FINANCIAL YEAR; OR

2. TURNOVER (INCOME) OF 200 CRORE RUPEES OR MORE DURING THE PRECEDING FINANCIAL YEAR; OR

3. OUTSTANDING LOANS OR BORROWINGS FROM BANKS OR PUBLIC FINANCIAL INSTITUTIONS EXCEEDING 100 CRORE RUPEES OR MORE AT ANY POINT OF TIME DURING THE PRECEDING FINANCIAL YEAR; OR

4. WHICH HAS ACCEPTED DEPOSITS OF 25 CRORE RUPEES OR MORE AT ANY POINT OF TIME DURING THE LAST FINANCIAL YEAR;

c) EVERY PRIVATE COMPANY HAVING

I. TURNOVER OF 200 CRORE RUPEES OR MORE DURING THE PRECEDING FINANCIAL YEAR; OR

II. OUTSTANDING LOANS OR BORROWINGS FROM BANKS OR PUBLIC FINANCIAL INSTITUTIONS EXCEEDING 100 CRORE RUPEES OR MORE AT ANY POINT OF TIME DURING THE PRECEDING FINANCIAL YEAR:

PROVIDED THAT AN EXISTING COMPANY COVERED UNDER ANY OF THE ABOVE CRITERIA SHALL COMPLY WITH THE REQUIREMENTS OF SECTION 138

AND THIS RULE WITHIN SIX MONTHS OF COMMENCEMENT OF SUCH SECTION.

ELIGIBILITY FOR APPOINTMENT AS INTERNAL AUDITOR

SUCH CLASS OR CLASSES OF COMPANIES AS MAY BE PRESCRIBED SHALL BE REQUIRED TO APPOINT AN INTERNAL AUDITOR, WHO SHALL EITHER BE A CHARTERED ACCOUNTANT OR A COST ACCOUNTANT, OR SUCH OTHER PROFESSIONAL AS MAY BE DECIDED BY THE BOARD TO CONDUCT INTERNAL AUDIT OF THE FUNCTIONS AND ACTIVITIES OF THE COMPANY.

THE CENTRAL GOVERNMENT MAY, BY RULES, PRESCRIBE THE MANNER AND THE INTERVALS IN WHICH THE INTERNAL AUDIT SHALL BE CONDUCTED AND REPORTED TO THE BOARD.

REQUIREMENT FOR FILING OF FORM MGT-14 WITH THE ROC ON APPOINTMENT OF THE INTERNAL AUDITOR

THE APPOINTMENT OF INTERNAL AUDITOR CAN BE DONE ONLY BY MEANS OF A RESOLUTION PASSED AT THE MEETING OF THE BOARD AS SPECIFIED UNDER RULE 8 OF THE COMPANIES (MEETING OF BOARD AND ITS POWERS) RULES, 2014 AND ACCORDINGLY, THE COMPANY IS ALSO REQUIRED TO FILE FORM MGT-14 WITH THE REGISTRAR WITHIN 30 DAYS FROM THE DATE OF PASSING OF RESOLUTION BY THE BOARD. HOWEVER, FILING OF RESOLUTIONS UNDER CLAUSE (G) OF SUB-SECTION (3) OF SECTION 117 HAS BEEN EXEMPTED FOR PRIVATE COMPANIES VIDE MINISTRY OF CORPORATE AFFAIRS NOTIFICATION NO.G.S.R.464(E) DATED 05.06.2015. HOWEVER, THE PRIVATE COMPANY IS STILL REQUIRED TO COMPLY THE REQUIREMENTS OF SECTION 179.

AUTHORITY TO APPOINT THE INTERNAL AUDITORS

RULE 13(2) OF THE COMPANIES (ACCOUNTS) RULES, 2014 SET FORTH THAT THE AUDIT COMMITTEE OF THE COMPANY OR THE BOARD SHALL, IN CONSULTATION WITH THE INTERNAL AUDITOR, FORMULATE THE SCOPE, FUNCTIONING, PERIODICITY AND METHODOLOGY FOR CONDUCTING THE INTERNAL AUDIT.

STATUTORY AUDITORS CANNOT BE APPOINTED AS INTERNAL AUDITORS

MCA CIRCULAR NO. 29 OF 1976, DATED 27-8-1976 STATES THAT THE INTERNAL AUDITOR IS APPOINTED BY THE MANAGEMENT AND HENCE IS IN THE POSITION OF AN EMPLOYEE, WHEREAS THE STATUTORY AUDITOR IS APPOINTED BY THE COMPANY IN ACCORDANCE WITH THE PROVISIONS OF SECTION 224 [SECTION 139 OF THE COMPANIES ACT, 2013] AND THE AUDITOR IS REQUIRED TO PERFORM THE DUTIES ENJOINED ON HIM UNDER SECTION 227 [SECTION 143 OF THE COMPANIES ACT, 2013] AND THE RULES/ ORDERS ISSUED THERE UNDER. AS SUCH, IN THE OPINION OF THE DEPARTMENT (MCA), A STATUTORY AUDITOR OF A COMPANY CANNOT ALSO BE ITS INTERNAL AUDITOR.

FORMATION OF POLICY AND PROCEDURE FOR APPOINTMENT OF THE INTERNAL AUDITOR

THE COMPANIES (ACCOUNTS) RULES, 2014 PROVIDES THAT THE AUDIT COMMITTEE OF THE COMPANY OR THE BOARD SHALL, IN CONSULTATION WITH THE INTERNAL AUDITOR, FORMULATE THE SCOPE, FUNCTIONING, PERIODICITY AND METHODOLOGY FOR CONDUCTING THE INTERNAL AUDIT.

EXISTING COMPANIES NEED TO APPOINT THE INTERNAL AUDITORS WITHIN A PERIOD OF SIX MONTHS, I.E. BEFORE 30TH SEPTEMBER, 2014

IN CASE OF AN EXISTING COMPANY, THIS NEEDS TO APPOINT INTERNAL AUDITORS PURSUANT TO THE PROVISIONS OF SECTION 138 OF THE COMPANIES ACT, 2013 READ WITH RULE 13 OF THE COMPANIES (ACCOUNTS) RULES, 2014, SHALL APPOINT THE INTERNAL AUDITOR WITHIN A PERIOD OF 6 MONTHS FROM THE COMMENCEMENT OF THE SECTION, I.E. NEEDS TO COMPLY WITH THE REQUIREMENT BEFORE 30TH SEPTEMBER, 2014.

SCOPE OF INTERNAL AUDIT

SUB-SECTION (2) OF SECTION 138 GIVES POWER TO CENTRAL GOVERNMENT TO MAKE RULES AND PRESCRIBE THE MANNER AND THE INTERVALS IN WHICH THE INTERNAL AUDIT SHALL BE CONDUCTED AND REPORTED TO THE BOARD. RULE 13 DOES NOT PROVIDE THE SCOPE OF INTERNAL AUDIT. HOWEVER, RULE 13 PRESCRIBED THAT THE AUDIT COMMITTEE OF THE COMPANY OR THE BOARD SHALL, IN CONSULTATION WITH THE INTERNAL AUDITOR, FORMULATE THE SCOPE, FUNCTIONING, PERIODICITY AND METHODOLOGY FOR CONDUCTING THE INTERNAL AUDIT.

POWERS AND DUTIES OF INTERNAL AUDITOR

THERE ARE NO POWERS AND DUTIES OF INTERNAL AUDITOR PRESCRIBED UNDER THE ACT. THE SAME MAY BE GOVERNED BY THE TERMS OF REFERENCE OF THE APPOINTMENT OF INTERNAL AUDITOR WHICH MAY BE DECIDED MUTUALLY BETWEEN THE COMPANY AND THE INTERNAL AUDITOR. PUNISHMENT AND COMPOUND ABILITY THERE ARE NO SPECIFIC PENAL PROVISIONS PROVIDED IN THIS SECTION 138. THEREFORE THE PENAL

PROVISIONS UNDER SECTION 450 WOULD APPLY IN CASE OF ANY NON-COMPLIANCE OF THIS SECTION. ACCORDINGLY, FOR CONTRAVENTION, THE COMPANY AND EVERY OFFICER OF THE COMPANY WHO IS IN DEFAULT SHALL BE PUNISHABLE WITH A FINE UPTO RS. 10,000, IN CASE THE CONTRAVENTION IS A CONTINUING ONE THEN THE FURTHER FINE SHALL BE RS. 1,000 EVERY DAY. THE OFFENCES UNDER THIS SECTION ARE COMPOUNDABLE UNDER SECTION 441 OF THE ACT.

- INTERNAL AUDIT & CARO
- U/S 227 (4A) COMPANIES ACT 1956
  - SEC 143(11) OF COMPANIES ACT 2013
- 12 JUNE 2003
  - CARO 2020 [25/02/2020]

INTERNAL AUDIT & CARO

CLAUSE (XIV) OF CARO, 2020

- **WHETHER THE COMPANY HAS AN INTERNAL AUDIT SYSTEM AS PER THE SIZE AND NATURE OF ITS BUSINESS**
- **WHETHER THE REPORT OF INTERNAL AUDIT SYSTEM IS CONSIDERED BY THE STATUTORY AUDITOR**

INTERNAL AUDIT & CARO

CLAUSE (XIV) OF CARO, 2020

- INTERNAL CONTROL SYSTEM (SA 200)
- EXTENT OF REPORTING (SA 315)
- MAJOR WEAKNESS
- ADEQUACY OF INTERNAL CONTROL (SA 200/ SA 315)
- CONTINUING FAILURE
- CHECKLIST & SPECIMEN REPORTING

- **APPLICABILITY OF CARO REPORT**
  - CARO 2020 APPLIES TO ALL COMPANIES INCLUDING FOREIGN COMPANY
  - EXCEPTION
    - ONE PERSON COMPANY (OPC)
    - SMALL COMPANIES
    - BANKING COMPANIES
    - INSURANCE COMPANIES
    - SECTION 8 COMPANIES
    - PRIVATE COMPANIES
      - GROSS RECEIPT ≤ RS. 10 CRORE
      - PAID-UP SHARE CAPITAL & RESERVE & SURPLUS ≤ RS. 1 CRORE
      - NOT A HOLDING COMPANY OR SUBSIDIARY OF A PUBLIC COMPANY
      - TOTAL BORROWINGS FROM BANKS OR PUBLIC FINANCIAL INSTITUTIONS ≤ RS. 1 CRORE

Internal Audit in Companies under Manufacturing Sector

Internal Audit of Manufacturing Company

Purchase, Store, Production, Sales, Marketing, Security, Lab, are important department of every Manufacturing Company, Internal audit have big role to analyze for smooth functioning of every department. Here is brief function of Internal audit of Manufacturing Company:

Production Annexure - I

Risk	List of Controls
Production Planning	
(1) Untimely production as compared to the marketing requirements resulting in holding of inventory	Timely compilation of Production budget/plan for each of the product variety (e.g. OPC, PPC, Non-Trade etc.)
(2) Excess/short production as compared to plan	Pre-defined authority level for review and modification in the production plan
(3) Loss of production due to non-consideration of sales forecast/raw materials availability	Periodic review of Production Plan vis-à-vis changes in Sales Plan or availability of raw materials & documentation thereof

	Compilation & documentation of reason-wise analysis of actual consumpt3ion vis-à-vis standard consumption
	Shift-wise production data logging in place

Consumption standard/norms & actual consumption	
Excess production cost due to excess consumption of raw materials, ingredients, utilities or high process wastage	Compilation of documented consumption standards i.e BOM
	Periodic comparison of actual capacity utilization
	Review of periodicity of comparison of actual consumption and standard consumption and compilation of reason-wise variance analysis for deviation in consumption
	Identification of controllable and non-controllable factors resulting in variation in the consumption norms and department's action plan to remedy the controllable factors
	Verification of overall material reconciliation highlighting total

	material consumed, standard input-output norms and actual

Capacity Utilisation	
(1) Opportunity loss due to inadequate capacity utilization (2) Excessive utilization of production capacity (3) Interruption in production process	Periodic comparison of actual capacity utilization with the synchronized 'sales plan'

Documentation & record maintenance:	
(1) Inadequate documentation of production data/results, may result in incorrect decision or non-availability of timely information	Compilation of Daily Production Report from DCS & its validation by the authorized personnel
	Periodic review of conformance to the ISO requirement
(2) Ambiguous authority levels /access for generation of production documentation resulting in unauthenticated generation of production data	Pre-defined authority levels to generate, add, and modify production data in DCS/SAP

Quality control and inspection report:	
(1) Absence of standard quality control parameters resulting in sub-standard production/ high re-work cost (2) Non-standardized Inspection Reports resulting in inconstancy in inspection of parameters	Standard Operating Procedures for quality control and inspection including in-built process controls
	Review of QC norms periodically to ensure their validity
	Adherence to the pre-determined sampling techniques & exception reports for the results deviating from the QC norms
	Review of complaints received by the Production department pertaining to quality/quantity of cement sold in the market or lying at godown/s
	Customer-complaints closed in time for amicable solution
	Engagement of external agency for quality validation are approved and reports are reckoned to pre-empt possibility of quality non-conformity issues.
	The process for re-working QC failed products exists after obtaining due approval from appropriate authority against QC failed product

	All products are bagged after the same being qualified for /passed by QC
	Variations over standard Bag consumption is measured and monitored

Review of process losses and recycling	
Excessive process losses or inadequate recycling of materials due to improper monitoring of process parameters	Process loss incurred during the period are compared with the standard
	System exists of analysing the reasons for abnormal process losses, if any and documentation of remedial action plan
	Identification of quantity of material non-conforming to the specification and sent for recycling.
	Preparation of comparative analysis of percentage increase or decrease in the recycling materials and reasons thereof

Preventive & break-down maintenance:

Non-adherence to the preventive maintenance schedule resulting in process bottleneck / plant shut down/ loss of production.	Compilation of preventive maintenance schedule & its adherence
	Compilation of report on breakdown maintenance and opportunity loss of production are measured
	Ascertainment of the impact of breakdown maintenance on the production schedule

MIS Reports	
(1) Inadequate MIS reports resulting in unauthenticated/ unreliable production details resulting in improper decision (2) Inconsistency in compilation of production reports due to non-standardized definition of periodicity	Compilation of MIS reports from the source data & their approval by the authorized personnel

Deployment of Workmen on Contractual basis

Risk	List of Controls
Assessment of requirement and approval	
(1) Unskilled labour engaged at the rate applicable for skilled labour; (2) Labour called without requirement for the same; (3) Jobs to be done not approved by appropriate authority; (4) Actual engagement not in tandem with requirement	Skill profiles of labourers are available/maintained and Job Requisitions raised against the specific skill requirement availability. Requisitions are raised with job description indicating requirement (number. of heads) for manpower. All job requisitions are approved by appropriate authority. Excess/short engagement in comparison to Requisition is traced, compared for deviations with reasoning. Purchase/Service Orders are released against approved Requisitions.

Selection of Contractors and their approval	
(1) Non-standard P.O terms; (2) Un-competitive rates;	Standard order terms as to job nomenclature, payment terms etc. are maintained.

(3) High Rates; (4) Delay due to nonavailability of Contractor, who can handle the assignment	Contractors for a job is selected on competitive basis.
	List of Contractors are maintained for jobs on offer and addition/deletions are considered on approval by appropriate authority.

Labour identification and authentication	
(1) Ghost Workmen; (2) Same workmen deployed by multiple Contractors	Each labour is traceable against identification/ employment number with photograph.
	Periodical "parole" to identify dummy workmen is conducted by HR and Engaging Dept.
	Change/transfer of workmen from one Contractor to another is traced and records updated accordingly.

Wage agreements and adherence	
(1) Un-competitive /high rates; (2) Rates applicable are higher than prevalent local rates; (3) Non-update of labour rates for a long time	Systematic study as to rate contract fixation is carried out periodically and rates finalized accordingly.
	Benchmarking with local rates for pricing/labour contract rate is carried out.

	Effectiveness of fixed rate schedule verified periodically and it's validated from time to time.
	Labour rate agreements with Unions against specific skill/trade etc. are validated from time to time.

Fulfilment of safety requirements	
(1) Unsafe working environment; (2) No formal training to safe work mode; (3) Inadequate training and follow-up resulted in nonadherence to safety rules/ guidelines	Details of safety training to be imparted to Contract Workers with varied skill/ work engagement is documented.
	Safety Dept. certifies the training completion of the workmen before allowing to work/job.
	Adequacy of safety requirements are validated from time to time for ensuring compliance.

Engagement - Requirement vs. Actual	
(1) High rates due to high dependency on single Contractor;	List of multiple Contractors as per engagement in different Job area is available.

(2) Un-benchmarked rates;	Rates applicable are benchmarked and applied for rate fixation/PO.
(3) Dismal 'work permit' mechanism; (4) Uncertified jobs paid for;	'Work permits' are issued with predetermined strength required for the job and maintained in seriatim.
(5) Booking for labour supply and turnkey engagement for the same workmen;	Work permits on job completion are signed-off and jobs in Contractor Bills be traced therefrom.
(6) Uncontrolled entry-exit mechanism	Actual engagement is certified by the engaging Dept.
	Same contractor workforce is not allowed to work under 'turnkey' as well 'labour supply' to pre-empt possibility of multiple booking against same attendance.
	Lower or higher engagement against requirements or extra time required/ booked is compared and deviation with reasoning documented.
	Gate Security certifies entry/exit of workmen or "time recorder "and the same tallied with billing/hours booked/claimed.

Bill Payment and booking

(1) Non-deduction for drawing Co. material; (2) Attendance record not verified causing excess payment; (3) Penalty not inflicted; (4) Wrong passing of bills resulted in extra payment to Contractors; (5) Quality of jobs performed not reflected in certification as well payment; (6) Performance guarantee/ BG/SD not applied on Contractors for poor quality of jobs	Reconciliation of materials supplied to Contractors and passing on of appropriate impact against their billing is ensured before payment.
	System as to verification of 'Attendance Record' of the labourers maintained by Contractors and reconciliation with time billed/ engaged, for actual booking and that paid by the Contractor exists.
	Penalty for non-fulfilment of contractual obligation i.e. delay, quality adherence etc. are duly accounted for.
	Checks are carried out before making payment of bills as to: Rates, Attendance, Job, Quality etc.
	All appropriate taxes are levied / deducted and deposited in time.
	System of collecting Security Deposit or 'performance guarantee' or 'bank guarantee' to bind the contractor against quality issues exists.

Legal compliances under labour laws	
(1) Relevant licenses (by Company as well as Contractor) not obtained;	System in place to ensure necessary Licenses under relevant laws prior to engagement is obtained by the Contractor.
(2) Failure in filing statutory returns;	All necessary returns are filed timely by the Company.
(3) Engagement over stipulated working hours;	Engagement of labourers over stipulated hours are tracked.
(4) Breach of statues in engagement/ payment/ Factories Act	Overtime work is regulated through adequate and timely supply of labour at the 'job area'
	All Applicable statues e.g. Minimum Wages, Factories Act etc. are followed and adhered to.

Principal employer's liability	
(1) Wage distribution not certified;	Lack of proof for payment to workmen
(2) Workforce interest not protected by Principal Employer; Fines/ Penalties	P.F, E.S.I (Employee State Insurance) and other statutory dues are monitored by HR/ Admin. to ensure

may be inflicted by appropriate authority	timely deposit and protection of workforce interest.

Fixed Asset

Risk	Control
ASSETS MANAGEMENT POLICY/DOCUMENTATION/SOP	
Policy/SOP for fixed assets not available	Documented SOP's for fixed assets

CAPITAL BUDEGT & APPROVALS	
Capital Expenditure Policy not available	There is a Capital Expenditure Policy highlighting the procedures to be followed for estimation of Capex & pre-defined authority for sanction of the Capital Expenditure budget with value limits.
Inaccurate estimation of capital expenditures	Estimation of capital expenditures /sanction approved.
Technical & commercial feasibility studies not done	Technical & commercial feasibility studies are done before initiation of the specific Capex proposal.

Unauthorised capital expenditure .	The Capex is approved as per DOA.
Excessive delays	There is an internal mechanism to ascertain tracking of capital proposals till raising of POs to identify excessive delays

FIXED ASSETS REGISTER	
Missing Assets	A register of all fixed assets (including fully depreciated assets) is maintained and updated.
	There is adequate description of all assets to identify assets physically available.
	The FA Register is periodically reconciled with the financial records.
No Policy/SOP on physical verificatio n	SOP is established and all procedures are complied with.
	Physical verification of assets is carried out every year.
Company's assets physically not available	There is a set procedure for verification and confirmation of fixed assets lying with third parties.
Discrepancies observed during physical	All discrepancies are adjusted after taking approval as per DOA within time.

verification not adjusted.	
Title deeds not available	Physical verification of title-deeds is carried out periodically by officers not connected with assets accounting/assets administration.
Assets not being used	Periodic verification of Assets not in use is being done.

FIXED ASSET ADDITIONS	
Purchase of asset not authorised properly/ Non tracking of indent	Request for capital expenditure from user is received in standardized form. There is a separate identification number for each form.
	Formal documented approval as per DOA
	For every acquisition, Purchase order giving full details of fixed asset requirement.
	Every P.O. authorised as per DOA
	Actual transaction is as per P.O.
Lack of audit trail in ERP	Availability of audit trail in ERP/ SAP for all transactions

Unauthorised master record of asset	Master data (class, useful life, rate of depreciation) of new asset created subject to approval
Asset capitalised at WIP stage	Capitalisation only on the basis of 'put to use certificate' by proper person (technical person) only after inspection
Actual utilisation exceed the budgeted allocation	Approval as per DOA is obtained wherever actual utilisation exceed the budgeted allocation
No clear and correct distinction between capital and revenue expenditure	There is clear and correct distinction drawn between capital and revenue expenditure
Unduly delay in installation/commissioning/ commencement of warranty	Reasons are documented for delay in installation/commissioning/ commencement of warranty.

VALUATION OF ASSETS	
Wrong valuation of assets	System to ensure that cost consist of purchase price, import duties (if any), other non-refundable taxes & direct attributable cost for bringing the asset to its working condition for its intended use.

	Self-generated asset consist of direct as well as allocable factory expenses allocated on systematic basis.
Wrong valuation of assets	Fixed assets are revalued on adequate independent evidence.

SALE OF ASSETS	
Possibility of sale of performing assets	Disposal request from user.
Unauthorised sale	Approval as per DOA
Items replaced, scrapped or sold not removed/written off.	Items replaced, scrapped or sold are removed / written off from the books?
Profit or loss on sale of fixed assets	Profit or loss on sale of fixed assets is properly disclosed in the accounts

MOVEMENT/TRANSFER OF ASSETS	
Loss of asset / non accountability of asset	The standard form filled by user as well as sending and receiving locations.
	There is a system to track the assets transferred on a temporary basis.

Unauthorised transfer	Transfer of asset should be approved as per DOA.
Transfer not recorded in books	Transfer is properly recorded in the books

IDENTIFICATION OF IDLE ASSETS	
No system to identify idle assets	Documented process in place to identify the idle assets
	Identification always from user documenting the reason to classify asset as idle asset.

WRITE OFF OF ASSETS	
Write off approval for shortage/ missing asset is not obtained	Write off note for any shortage/missing asset is put up for approval as per DOA.

CAPITAL WIP	
Delay in capitalisation leading to deferment of depreciation charge. Under	Capitalisation of asset within two days of its ready to use certificate obtained
	Ageing analysis to find out old WIP & reasons for non- capitalisation

statement of F.A. / depreciation	Projects scrapped is charged off.

CAPITAL ADVANCE	
Advance is given to unauthorised vendor	Request from vendor for capital advance, which should be approved as per DOA
	Analysis of vendor history before granting of any advance
Non availability authentic documentary evidence	Signed agreement for purchase of fixed asset mentions all the terms including advance to be given
	Analysis of unadjusted advances.
Excess payment to capital creditor	System to check any balance in advance account before making any payments.

SECURITY OF ASSETS	
Company's asset not properly Safeguarded	Controls to ensure Physical Safeguarding of Assets.
Company's asset wrongly owned by third party	All invoices/registration cards (for motor vehicle)/title deeds (for land, building etc.) clearly specifies the TCL ownership.
Encroachment of land	Adequate provisions to protect the asset from encroachment.

TRACKING OF INTERNAL RATE OF RETURN	
Gaps between the projected NPV/IRR and actual asset performance	Analysis of asset performance against the projected NPV/IRR is being done.
	Reasons for gaps between the projected NPV/IRR and actual asset performance are documented.

STATUTORY-COMPLIANCES	
Non identification of Impairment to the asset	Documented & approved process in place for identification of Impairment & implementation of same
	Periodical review of the assets for the impairment.
Non-compliance with Companies Act	Depreciation is charged as per provisions of the Companies Act.
No/under cover of insurance for Assets	Sum insured justifies the replacement value of Assets

SI. No.	Functions

(1)	Plant Operation
a)	Yield-Machinery, Manpower & Material
b)	Budgeted Variance of Production
c)	Power Analysis
d)	Labour Analysis
e)	Production Delay due to unavailability of Resources (Material, Labour, Machinery & others)
f)	Capacity Utilisation of Machine & Labour
g)	Transit damaged Material
h)	Abnormal Losses, if any
i)	Quality Audit of Inward and Outward
j)	Review of Man Power Allocation Planning
k)	Review of Plant HR Policy-Labour Policy 2

(1)	Security
(i)	Security Register Abnormal Report Review (Shift Change)
(ii)	Rotation of Security Staff
(iii)	Insurance of Machinery Labour, Factory, Vehicle & Cash in Transit

(iv)	Input & Output Matching with Inward/Outward/Dispatch/Tally etc.
(v)	Audit of Security Gate Process

Sl. No.	Functions
(2)	Purchase
a)	Review of PO Made during the Period
b)	Listing of unauthorized Purchase as per Power Limit
c)	Review of Contract Made during the period
d)	Review of Vendor Selection Process
e)	Review of Vendor Payment Policy
f)	Overdue PO
g)	Vendor Performance
h)	Review of Forward Contract

Sl. No.	**Functions**
(1)	Stores Audit

a)	Inward /Outward of Store Register with Gate Records
b)	Review of Inward & Issue Activity
c)	Adhoc. Audit of Bin Card Maintenance
d)	GRN Date vs. Security Date Review
e)	Review of Quality Control of Stores items
f)	Review of Store Management
g)	Review of Action taken on Short Delivery
h)	Review of Slow/Non-Moving Stock
i)	Minimum order Quantity Review

Sl. No.	Functions
(1)	Statutory compliance
A.	Excise Register Matching with Inward & Outward
B.	Job work Register
C.	TDS Deduction Practice
D.	Review of GST
E.	Foreign Payment Review

F.	PF & PT Review
G.	Cases Pending Under Negotiable Instrument Act

Sl. No.	Functions
(1)	ROC compliance & Corporate Governance
a)	Review of Minute Books
b)	Review of Filing
c)	Review of Power Used by Company Officer
d)	CSR activities
e)	Any Non-Compliance as per Companies Act

Sl. No.	**Functions**
(1)	Ledger Scrutiny

Sl. No.	Functions
(1)	Cash & Bank Review

a)	BRS
b)	Physical Verification Cash
c)	LC Discounting & Charges
d)	Interest & Charges Review
e)	Stale Cheque Report
f)	Cheque Bounce Report
g)	Fund Management

Sl. No.	Functions
(1)	Corporate HR & Payroll
a)	Application of HR Policy
b)	Review of Reimbursements
c)	Review of Grievances
d)	Status of Vishakha Committee Report Implementation
e)	Surprise Head Count as per attendance Report
f)	Reconciliation of Employee Loan & Advances

g)	Review of Staff Welfare (Medical, working Environment, Staff Motivation, Training)
h)	Late Coming Report
i)	Performance Review of System, Policy & Technology

Sl. No.	Functions
(1)	Audit of Exp.
a)	Verification of Bills with ERP
b)	Approval Review of Bills
c)	Review of Bill Supporting
d)	Review of Debit Note-To be Raised
e)	Trend Analysis according to Sales/Production
f)	Forex Gain/Loss Calculation

Sl. No.	Functions
(1)	MIS Authenticity

Sl. No.	Functions
(1)	Audit of Sales
a)	Verification of Bills with ERP
b)	Review of Bill Supporting
c)	Review of Credit Note-To be Raise/Raised
d)	Review of Transport Challan Attached with Invoice
e)	Penalty & Price Variation Review
f)	Budgetary Performance
g)	C & F Form Status
h)	Utilisation of Advance Authorization Licenses

Sl. No.	Functions
(1)	Marketing
a)	Customer Complaint Addressal Review
b)	Target Performance-KAM c Debtors Performance-Ageing

Sl. No.	Functions
(1)	Business Analysis
a)	Industry Overview-Future Prospect of Business
b)	Ratio Analysis - In comparison with Industry
c)	Technology Review
d)	Costing & Pricing of Product

Sl. No.	Functions
(1)	Capex
a)	Capex Bills Review
b)	Capitalization Checking
c)	FAR Checking
d)	Barcode & Tagging Status

Sl. No.	Functions
(1)	Overview Assurance on Internal Control

Sl. No.	Functions
(1)	Transporting & Logistic
a)	Review of Transportation Contract & Rate
b)	Transportation Expense & Pooling Review
Sl. No.	**Functions**
(1)	Follow up of Previous Audit

Sl. No.	Functions
(1)	Stock Audit

Sl. No.	Functions
(1)	Any other area Requested by management

CHAPTER – 16 AUDIT OF DIFFERENT SERVICE ORGANISATIONS

INTERNAL AUDIT CAN ADD VALUE

- FOCUSING ON RISK AREAS
- EVALUATING & RECOMMENDING PROCESS IMPROVEMENT OPPORTUNITY
- RESEARCHING BEST PRACTICES & HELPING IN IMPROVEMENT
- MONITORING THE IMPLEMENTATION OF POLICIES & STRATEGIES
- COST-EFFECTIVE SOLUTION

AUDIT OF HOSPITALS

- AUDITOR SHALL APPLY FOLLOWING STEPS TO CONDUCT THE AUDIT OF HOSPITAL

1. AUDITOR SHOULD CHECK THE LETTER OF APPOINTMENT TO ASCERTAIN THE SCOPE OF RESPONSIBILITIES.

2. OWNERSHIP AND CONTROL OF THE INSTITUTION.

3. PROCESS (E.G ADMISSION, RELEASE, OUTDOOR CHECK-UP, PATHOLOGY AND OTHER TEST FACILITIES, OPERATION THEATRE FACILITY, VACCINATION ETC.) AND RELATED CONTROLS TILL REVENUE GENERATION.

4. DONATION, SPECIAL GRANT, INTEREST AND/ OR DIVIDEND INCOME ETC. TO BE VALIDATED THROUGH NECESSARY SUPPORTING DOCUMENTS.
    - SOURCE SHOULD BE IDENTIFIED.
    - ACCOUNTING IS DONE PROPERLY

5. ENSURE PURPOSIVE DONATIONS, GRANTS ETC. SPENT FOR THE PARTICULAR PURPOSE ONLY.

6. CLEAR DISTINCTION BETWEEN CAPITAL EXPENDITURE & REVENUE EXPENDITURE.

7. STANDARD OPERATING PROCEDURE W.R.T EXPENSES (CAPEX & OPEX).

8. VERIFY THE SYSTEM OF INTERNAL CHECK AS REGARDS TO PURCHASES & ISSUE OF STORES, MEDICINES, MEDICAL EQUIPMENT ETC.

9. EXAMINE THE APPOINTMENT OF THE STAFF, VISITING SPECIALIST DOCTORS, PAYMENT OF SALARIES ETC. FOR EXPENDITURE BOOKING VALIDATION.

10. PHYSICAL VERIFICATION OF INVESTMENTS, FIXED ASSETS & INVENTORIES.

11. CHECK CAPITAL EXPENDITURE AND DEPRECIATION RATES CHARGED IN THE BOOKS OF ACCOUNTS.

12. ACCOUNTING PRINCIPLES FOLLOWED FOR RECORDING OF TRANSACTIONS.

AUDIT OF EDUCATIONAL INSTITUTION

i. Documents relating to formation of the institution, affiliation, Management structure, Governing Body, ownership etc. requires due attention for fund monitoring, donation, spent approval process, affiliation fees payment etc.

   Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

ii. Approving authority for expense, fund transfer, bank account operation etc. Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, especially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

iii. Semester/Class-wise Student Register with details of Student name, address, Aadhar No./Card, Guardian details, Contact No. etc. and fee structure (full fees, half fees, sanctioned waiver etc.) mapped for ensuring accuracy of collection. Where collection through direct Banking takes place, the Bank Statement to be equivated with 'fees receivable/recoverable' for completeness check and proper revenue /collection (advance/ arrear) recognition. Fees collected and Fees Book counterfoil reconciliation also can be carried out, for fees collected at the Counter. Collection against every student, whose names are appearing in the 'Student Register' to be validated and unpaid ones to be followed-up.

iv. Updation of 'Student Register' w.r.t discontinued, transferred students, drop-outs etc. to be carried out on timely basis.

v. Fees condonation by appropriate authority to be considered for reconciliation between receivable fees and received.

vi. Admission and other collections (late fees, transfer charges etc.) need to be tracked for separately and booked under appropriate Account Heads.

vii. Confirm that hostel dues were recovered before students' accounts were closed and their caution deposits appropriately adjusted/refunded.

viii. Verify other sources of income (rental income from landed property with the rent rolls, bank Fixed Deposit interest from Deposit Certificates etc.)

ix. Grants received with the relevant papers of grant.

x. Appropriate account head for Grant receipt and spent eligible thereunder to be checked for compliance.

xi. Review of Receipts and Payments, Income and Expenditure for completeness and accuracy of Fund balances and bank balances.

xii. Completeness and accuracy of income and expenditure need to be ensured.

xiii. All statutory deposits P.F, Municipal /Corporation Taxes, Affiliation Fees etc.), filing to be checked for compliance.

xiv. Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.

xv. Vouch in the usual manner all establishment expenses, approvals and enquire into any high-volume expenditure.

xvi. Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. against the spent booked for the period under review and physical existence. These should be checked by reference to Stock Register and values applied to various items should also be test checked.

xvii. Appropriate Fund Accounts are maintained to verify dedicated Bank balance tallies with the books maintained by the Organization.

AUDIT OF HOTELS

INTERNAL CONTROL:

THE HIGHEST/ BIGGEST PROBLEM IN ANY HOTEL BUSINESS IS PILFERAGE (LEAKAGE OF CASH) & SO THERE MUST EXIST A STRONG INTERNAL CONTROL SYSTEM TO MINIMISE THE PILFERAGE & LEAKAGE. STRONG INTERNAL CONTROL SHOUL INCORPORATE FOLLOWING POINTS:

- EFFECTIVENESS OF ARRANGEMENT REGARDING RECEIPT & DISBURSEMENT OF CASH
- PROCEDURES FOR PURCHASE & STOCKING OF VARIOUS COMMODITIES & PROVISION
- PROCEDURES REGARDING BILLING OF THE CUSTOMERS IN RESPECT OF ROOM SERVICE, TELEPHONE, LAUNDRY ETC.
- SYSTEM REGARDING RECORDING & PHYSICAL CUSTODY OF ASSETS SUCH AS EDIBLES, WINES, CIGARATES, CROCKERY, CUTLERY ETC.

ROOM SALES & CASH COLLECTION:

- IDENTIFY VARIOUS SALES POINT WHICH GENERATES REVENUE. EG. – ROOM SALES, RESTAURANT, ROOM SERVICE, MINI BAR, SPA, BANQUET INCOME
- CHECK THAT TOTAL SALES MATCHES WITH SALES AT VARIOUS SALES POINTS

THESE 3 THINGS NEEDED TO BE CHECKED SPECIFICLLY

- ACCOMODATION
  - I. GRADE WISE ROOM TARIFF MUST BE VERIFIED WITH BILING DESK
  - II. OTHER SERVICES (SALES POINT) ROOM SERVICES, MINIBAR, CLUB FACILITY SHOULD BE BILLED PROPERLY
- DAILY OCCUPANCY REPORT
  - I. CHECKIN REPORT
  - II. CHECKOUT REPORT
  - MATCHED WITH THE BILLING REPORT
- FOOD BILL WITH KOT (KITCHEN ORDER TAKEN) & SIGNED CUSTOMER COPY AS EVIDENCE OF CONSUMPTION

STOCK

- THE STOCK SHOULD BE REGULARLY UPDATED & PERIODICALLY VERIFIED. EX. UTENSILS PURCHASED & ISSUED TO HOUSEKEEPING AS KITCHEN STOCK IN HOTEL OF FOOD & BEVERAGES
- USE PROFESSIONAL VALUER FOR COUNTING & VERIFICATION OF STOCK ON CONTINIOUS BASIS
- AUDITOR SHOULD ENSURE HIS PRESENCE AT LEAST FOR PART OF THE TIMES DURING VERIFICATION PROCESS
- THE FIXED ASSET REGISTER SHOULD BE PROPERLY MAINTAINED & UPDATED REGULARLY
- FOLLOWING ADDITIONAL POINTS NEED TO BE CHECKED
  - MOVEMENT & TRANSFER OF STOCK SHOULD BE DOCUMENTED. EX. ROOM SERVICE TO HOUSEKEEPING, KITCHEN OUT ORDER TO ROOM SERVICE, ROOM SERVICE TO MINI BAR
  - KEY HOLDING REGISTER SHOULD BE MAINTAINED TO FIX RESPONSIBILITY (EX. STORE KEEPER SHOULD BE HELD RESPONSIBLE FOR ALL MOVEMENT OF STORE ITEMS)
  - UNAUTHORISED ACCESS SHOULD NOT BE PERMITTED

4. SECTION-WISE/ COSTCENTRE-WISE DETAILS:

FOR EXAMPLE, MANPOWER DEPLOYED, MAINTENANCE EXPENSES, MANAGERIAL EXPENSES ETC. TO BE MAINTAINED ON REGULAR BASIS FOR COST ANALYSIS

CASUAL LABOUR

- **THE AUDITOR SHOULD CONSIDER THAT PROPER & ADEQUATE RECORD MAINTAINED FOR CASUAL LABOUR**
- **PAYMENT OF WAGES TO CASUAL LABOUR SHOULD BE CHECKED PROPERLY.**

5. COST-REVENUE COMPARISON

FACILITY-WISE COMPARISON (FOR EXAMPLE SWIMMING POOL, GOLF COURSE, SPA, CLUB FACILITIES ETC.) TO BE MONITORED FOR SERVICE LEVEL ASSESSMENT WITH RECOVERY RATE/CHANGE, REQUIRED TO MONITOR SERVICE LEVEL.

6. RECEIPT & PAYMENT VERIFICATION

A. CHECK CUSTOMER BILL COPY TO ENSURE THAT THE STOCK ISSUED TO THEM & PAYMENT IS RECEIVED.

B. CHECK PAYMENTS MADE TO THE FOREIGN COLLABORATOR IF ANY

C. CHECK EXPENSES FOR PAINTING, REPAIRS, RENOVATION ETC.

D. CHECK PAYMENT OF SALARIES/ WAGES ETC.

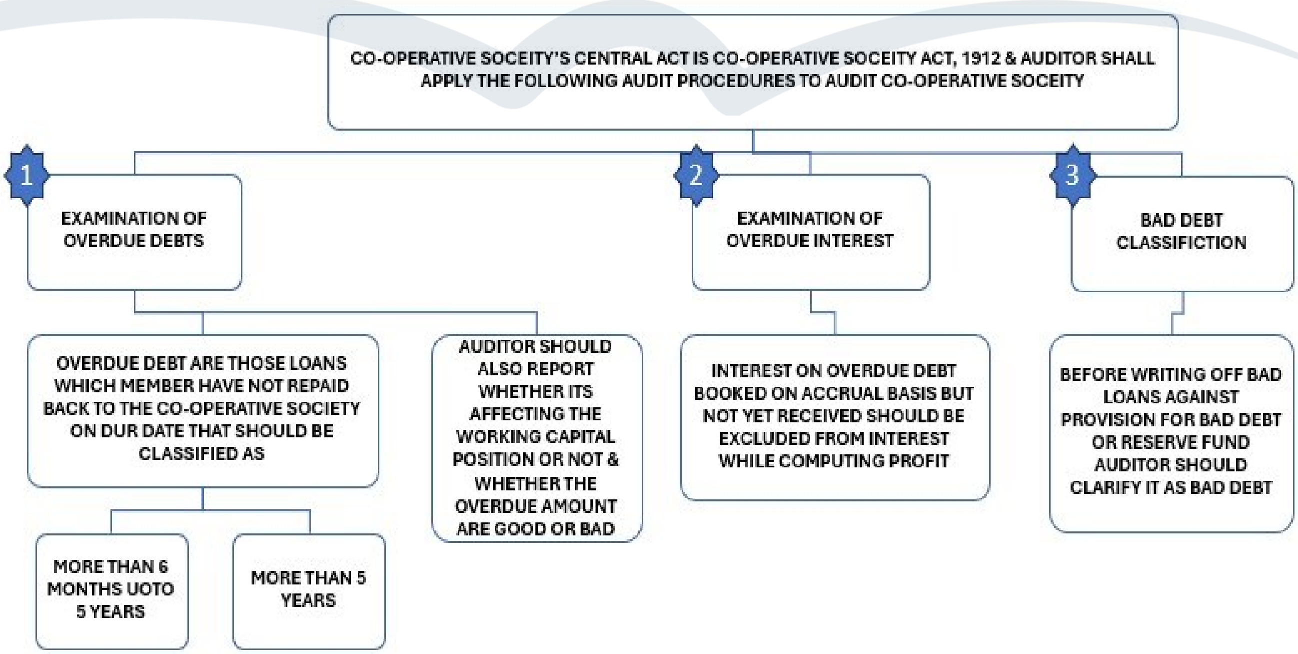
E. CHECK ANY INVESTMENT EXPENSES & IT'S INCOME.

F. CHECK WHETHER MONEY IS RECEIVED FROM THE TRAVEL AGENT AS PER THE CREDIT TERMS, ALSO THE COMMISSION PAID TO THE AGENT.

G. VERIFY RESTAURANT BILL WITH KOT ORDER

H. RECEIPT OF RESTAURANT/ HALL BOOKING/ BANQUET HALL BOOKING SHOULD BE VERIFIED

AUDIT OF CO-OPERATIVE SOCEITIES



CO-OPERATIVE SOCEITY'S CENTRAL ACT IS CO-OPERATIVE SOCEITY ACT, 1912 & AUDITOR SHALL APPLY THE FOLLOWING AUDIT PROCEDURES TO AUDIT CO-OPERATIVE SOCEITY

VERIFICATION OF ASSET & LIABILITY

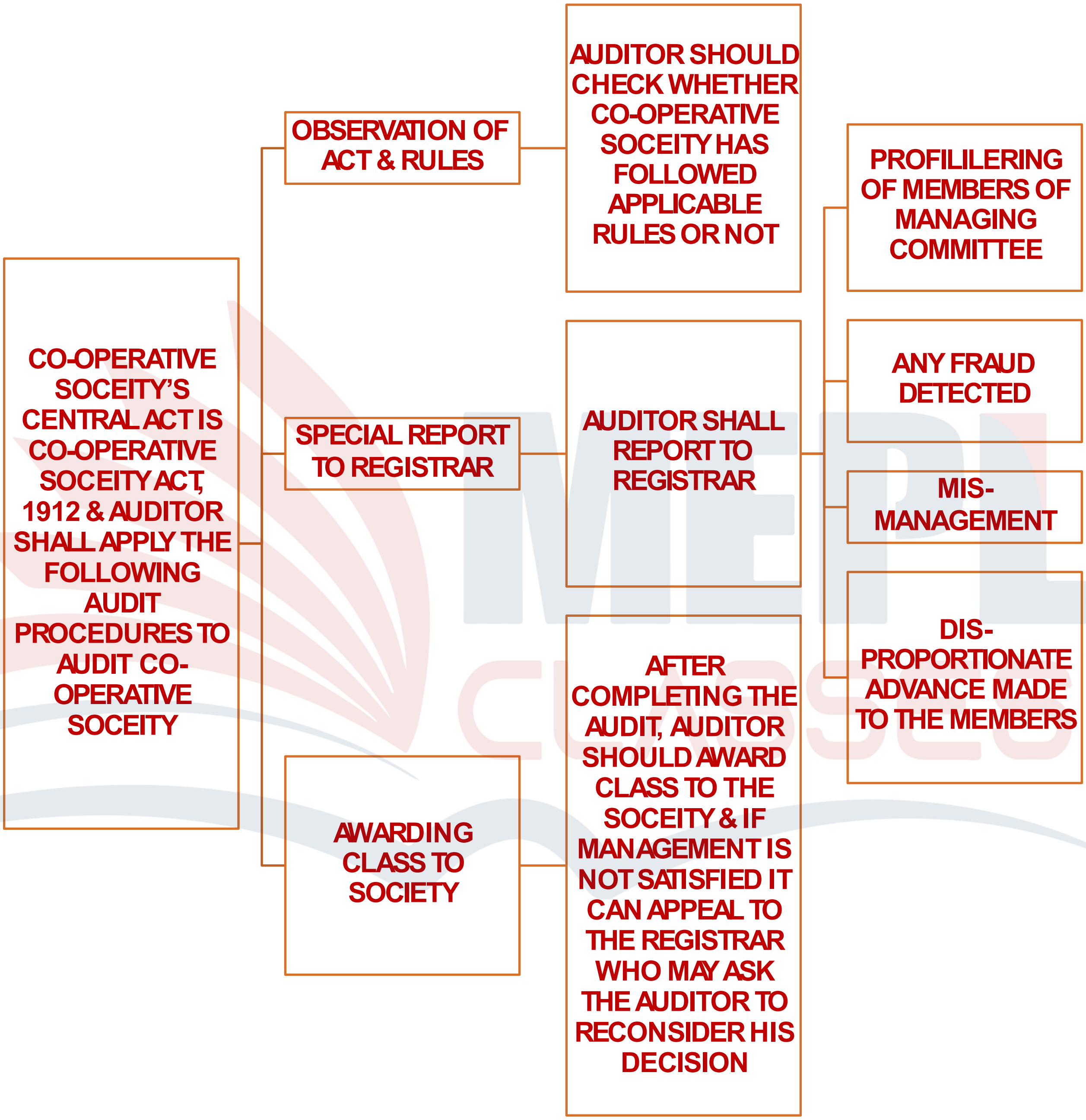
AUDITOR SHOULD CHECK WHETHER ASSETS & LIABILITY HAVE BEEN VALUED AS PER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES. HE SHALL ALSO CHECK THEIR EXISTENCE, OWNERSHIP/ OBLIGATION & VALUATION. FIXED ASSETS SHOULD BE VALUED AT COST LESS PROVISION FOR DEPRECIATION. CURRENT ASSETS AT COST OR REALISATION VALUE WHICHEVER IS LOWER.

ADHERENCE TO CO-OPERATIVE PRINCIPLE

AUDITOR SHALL CHECK THAT MUTUAL ASSISTANCE PRINCIPLE FOLLWED BY MEMBERS OR NOT

MEMBERS REGISTER & PASS BOOK

IF LAON GIVEN TO PERSON CHECK THAT HIS NAME WAS THERE IN REGISTER OF MEMBERS OR NOT & ALSO SEE HIS PASSBOOK TO CHECK WHETHER HE ACTUALLY RECEIVED THE LOAN OR NOT


CO-OPERATIVE SOCEITY'S CENTRAL ACT IS CO-OPERATIVE SOCEITY ACT, 1912 & AUDITOR SHALL APPLY THE FOLLOWING AUDIT PROCEDURES TO AUDIT CO-OPERATIVE SOCEITY
OBSERVATION OF ACT & RULES
AUDITOR SHOULD CHECK WHETHER CO-OPERATIVE SOCEITY HAS FOLLOWED APPLICABLE RULES OR NOT
SPECIAL REPORT TO REGISTRAR
AUDITOR SHALL REPORT TO REGISTRAR
PROFILILERING OF MEMBERS OF MANAGING COMMITTEE
ANY FRAUD DETECTED
MIS-MANAGEMENT
DIS-PROPORTIONATE ADVANCE MADE TO THE MEMBERS
AWARDING CLASS TO SOCIETY
AFTER COMPLETING THE AUDIT, AUDITOR SHOULD AWARD CLASS TO THE SOCEITY & IF MANAGEMENT IS NOT SATISFIED IT CAN APPEAL TO THE REGISTRAR WHO MAY ASK THE AUDITOR TO RECONSIDER HIS DECISION

NOTES:

I.

10 PERSON SHOULD APPLY TO THE REGISTRAR OF SOCIETY

U/S 6 OF CO-OPERATIVE SOCEITY ACT, 1912

- NOT PAY MORE THAN NOMINAL VALUE OF SHARES
- CANNOT HOLD GREATER THAN 20% OF THE SHARES OF CO-OPERATIVE SOCEITY

II.

SEC 17 (AUDIT OF CO-OPERATIVE SOCEITY)

- REGISTRAR SHALL AUDIT OR CAUSE TO BE AUDITED BY ANY PERSON AUTHORISED BY HIM
- THE AUDIT SHALL INCLUDE AN EXAMINATION OF OVERDUE DEBT AND VALUATION OF ASSET & LIABILITY
- REGISTRAR SHALL ALL THE TIME HAVE ACCESS TO THE DOCUMENTS (ACCOUNTS, PAPER, SECURITY ETC.) OF THE SOCEITY

III. APPOINTMENT OF THE AUDITOR IS DONE BY THE REGISTRAR OF THE CO-OPERATIVE SOCIETY. THE FEES OF THE AUDITOR IS FIXED BY THE CO-OPERATIVE SOCEITY BASED ON THE SCALE FIXED BY THE REGISTRAR.

IV. AUDITOR SHALL SUBMIT A COPY OF THE REPORT TO THE SOCIETY AND TO THE REGISTRAR DIRECLTY.

V. Duties of An Auditor:

- Auditor should be well-versed with the Co-operative Society Act, 1912.
- Any irregularities & mis-statement should be immediately point out the same.
- Auditor should go through the agreement between the society & the borrowing (i.e. repayment schedule & rate of interest)
- Balance Sheet / P/L & auditor report should be as per the proforma fixed by the Chief Auditor of the Co-operative Society of the State.
- Audit should be in accordance to the act & rules
- Loan given to the members are in accordance to the resolutions passed by the Managing Committee of the Society.
- Auditor should verify that the loan given is within the prescribed limit.

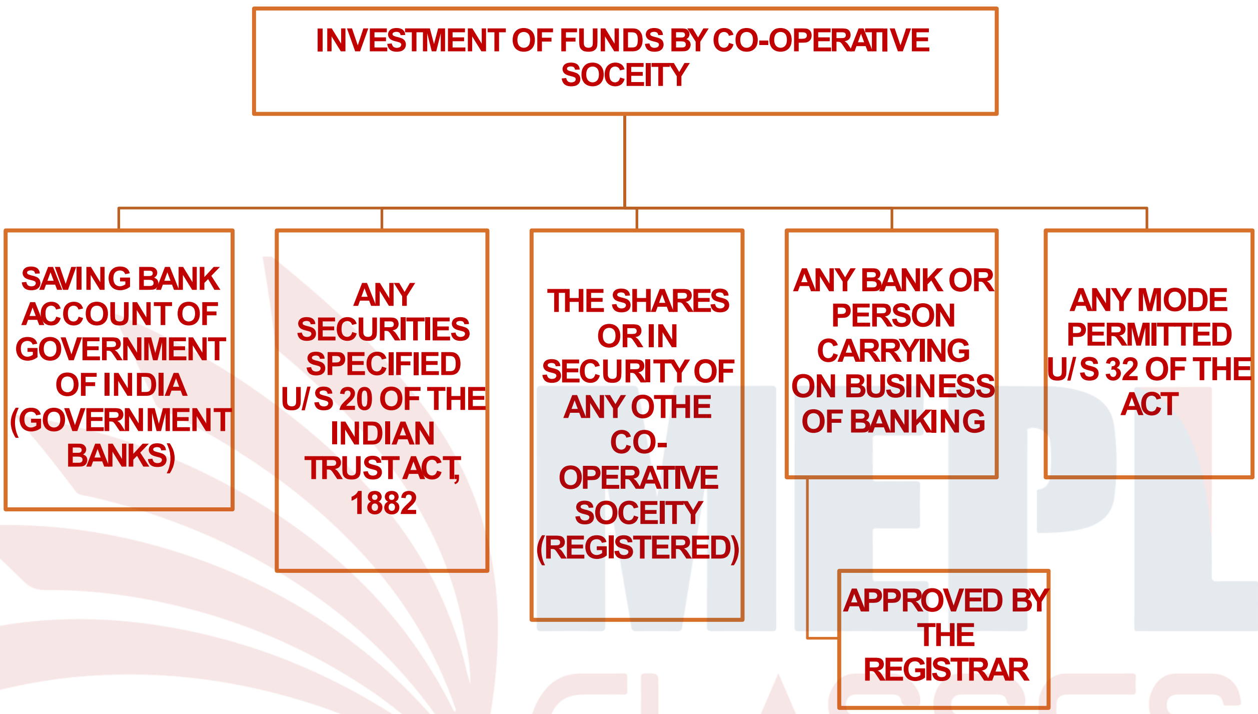
- The auditor should check whether the Co-operative Society is maintaining the list of ledgers as prescribed by the state u/s 43(H) of the Co-operative Society Act, 1912.

- Auditor should ascertain the number of shares held by each member of the society & within the prescribed limit

5 Books, Accounts, and Other Records of the Society

Under Section 43(H) of the Co-operative Society Act, 1912, the Government of a state can frame rules prescribing the books of accounts to be kept by a Cooperative society. Following books and accounts are prescribed by the Maharashtra Government.

- Cash Book
- General Ledger
- Stock register
- Personal Ledger
- Register of Members
- Register Shares and debentures
- Minutes books of general body meetings and committee meetings
- Property Register
- Register recording loan applications
- Maintenance of register of audit objections and their rectifications


INVESTMENT OF FUNDS BY CO-OPERATIVE SOCEITY
SAVING BANK ACCOUNT OF GOVERNMENT OF INDIA (GOVERNMENT BANKS)
ANY SECURITIES SPECIFIED U/S 20 OF THE INDIAN TRUST ACT, 1882
THE SHARES OR IN SECURITY OF ANY OTHE CO-OPERATIVE SOCEITY (REGISTERED)
ANY BANK OR PERSON CARRYING ON BUSINESS OF BANKING
APPROVED BY THE REGISTRAR
ANY MODE PERMITTED U/S 32 OF THE ACT

- RESTRICTION ON CO-OPERATIVE SOCEITY
  - RESTRICTION ON SHAREHOLDING
    - NO MEMBERS CAN HOLD MORE THAN 20% SHARE OF CO-OPERATIVE SOCEITY OR SHARES WORTH MORE THAN 1000/-
  - RESTRICTION ON TRANSFER OF SHARES
    - A MEMBER OF SOCIETY CANNOT TRANSFER THE SHARES OR INTEREST IN CAPITAL UNLESS
      - HE HAS HELD THE SHARE FOR 1 YEAR
      - TRANSFER IS MADE TO THE MEMBER OR THE SOCEITY
  - RESTRICTION ON LOAN
    - NO LOAN TO PERSON OTHER THAN MEMBER EXCEPT PRIOR APPROVAL OF REGISTRAR
    - SOCEITY WITH UNLIMITED LIABILITY CANNOT LEND MONEY ON THE SECURITY OF A MOVABLE PROPERTY EXCEPT PRIOR APPROVAL OF REGISTRAR OF SOCEITY
    - STATE GOVERNMENT HAS THE POWER TO PROHIBIT ANY SOCEITY FOR LOAN ON SECURITY OF IMMOVABLE PROPERTY
  - RESTRICTION ON BORROWING
    - SOCEITY CAN ACCEPT DEPOSIT OR LOANS FROM PERSONS WHO IS NOT THE MEMBER
      - SUBJECT TO THE LIMITS & CONDITIONS MENTIONED IN THE ACT & RULES OF THE CO-OPERATIVE SOCEITY ACT, 1912

RESERVE FUND & DISTRIBUTION OF PROFIT

- FIRST 25% OF NET PROFIT TO BE TRANFERED TO RESERVE FUND
- 10% OF THE BALANCE NET PROFIT AFTER TRANSFERING 25% TO RESERVE FUND
  - SOCEITY CAN CONTRIBUTE CHARITABLE PURPOSE WITH SANCTION OF REGISTRAR
- BALANCE OF THE CURRENT YEAR PROFIT & PAST YEAR PROFIT CAN BE DISTRIBUTED TO THE MEMBER OF SOCEITY
  - SUBJECT TO THE RULES & BYE LAWS OF THE SOCEITY
- DIVIDEND CAN BE DISTRIBUTED BASED ON RULES & BYE LAWS SUBJECT TO LIMIT OF 6.25%

NOTE:

- UNLIMITED LIABILITY SOCEITY CANNOT DISTRIBUTE PROFIT UNLESS SPECIAL ORDER PASSED BY STATE GOVERNMENT
- EXEMPTION ARE AVAILABLE TO THE REGISTERED SOCEITY FROM INCOME TAX, STAMP DUTY OR REGISTATION FEES.

CHAPTER – 17 Forensic Audit

Forensic Audit

Forensic (+) **Audit**

Forensic: Application of Scientific technique to investigate a crime to produce evidence in Court of Law

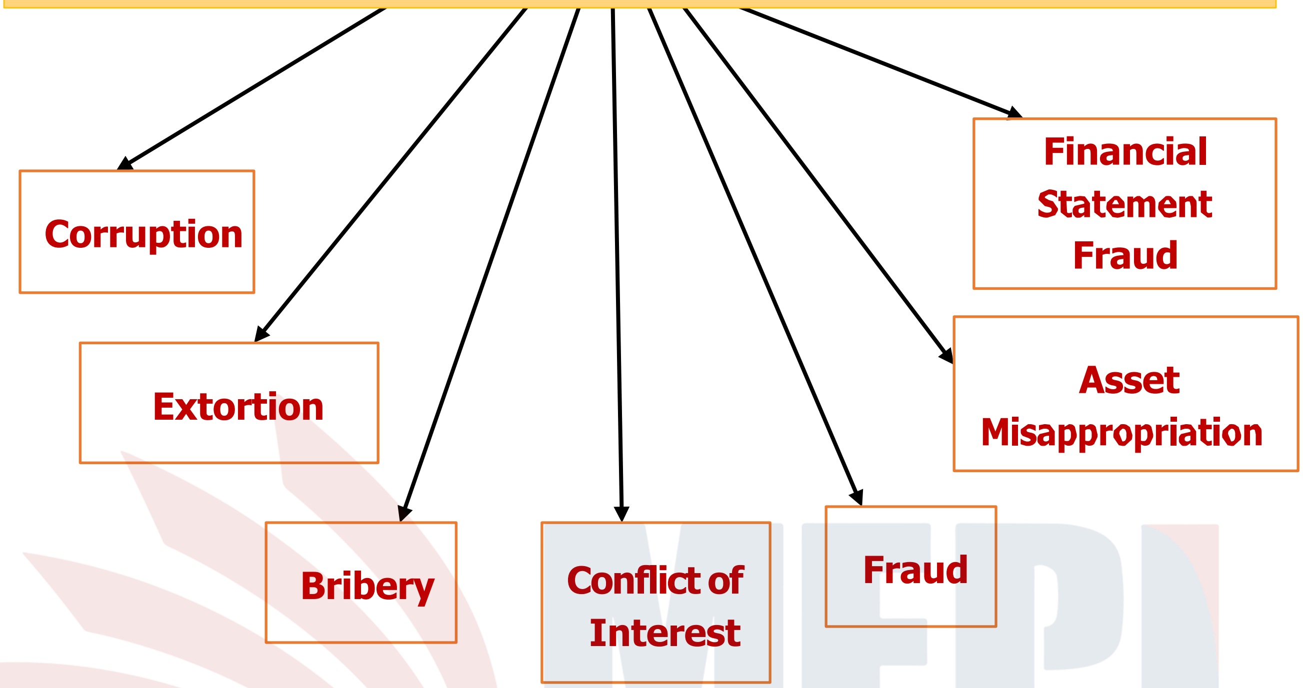
Audit: Independent examination of Financial Info of the company to give true s fair picture of financial position of company (ICAI)

Examination or Evaluation of Company Financial Information / Data to extract certain facts which can be used in Legal Proceedings / Court of Law
Postmortem Analysis – Proof something in the Court of Law
Forensic Auditor – Expert with Sound / Scientific knowledge in Accounting / Auditing with the knowledge of Legal / Law

WHAT IS FORENSIC AUDIT?

- A forensic audit is an evaluation and examination of an individual's or a firm's financial records to stem up evidence that can be used in a legal proceeding or court of law.
- A forensic audit may be directed to prosecute a party for embezzlement, fraud, or additional financial crimes.
- The auditor may also be called to help as an expert witness during trial proceedings of a forensic audit.

REASONS FOR FORENSIC AUDIT



1. Corruption:

Corruption is using advantage of your position in the organization to cause monetary loss to the company for your personal gain/advantage

Disadvantage – Company

Advantage – Fraud committing person

- Corruption is a significant obstacle to socio-economic development and also at different corporate levels.

- It consists of any illegitimate use of the office or dishonest behaviour and its resources.
- Forensic auditor attempts to look for accounts of extortion and bribery, or anything that will amount to or relate to any conflict of interest.

2. Extortion:

Using your connection/position to extort someone by force to gain advantage

Disadvantage – GVK (Company) against whom extortion is use.

Advantage – Adani → Person doing extortion.

- Taking a step ahead of any corruption, extortion involves the use of force, threat, or violence to extract money from another person/party.
- For the interest of the company, this may be done on the pretence of protection money or sophisticated cyber extortion schemes, small businesses, etc.

3. Bribery:

Dishonest act by one person by influencing his role/position in the organization favoring some other person or demonstrating profit to someone.

Advantage – Person getting influenced or Person influencing

Disadvantage – Company

Bribery refers to the conduct of dishonestly influencing one's position or role to receive something as well as promising something favourable to the party demonstrating such benefit.

4. Conflict of Interest:

Personal Profit →

Same as bribery

Using his position to gain [personal profit]

That is done to gain personal profit, and which is unfavourable to the company. This conduct forms the objective of a forensic audit.

5. Fraud:

SA 240 →

- Material Misstatement or
- False or willful representation of Fact

Balance Sheet Loss (Hide) →

- Intention to Deceive
    a) Defraud – Fraud
    b) Advantage gain Personal gain – Monetary Loss / Injury

Insolvent Delist →

- Fraud – Company share 500 cr. profit – Fact representation with an intention to deceive

There are a few reasons related to the fraud associated with the financial circle of any company.

Those are as follows:

- False and Willful representation or Assertion.
- Perpetrator of Representation.
- Intention to deceive.
- The representation must relate to a fact.
- Any other act fitted to deceive.
- Any such 'act or omission' that the law specially declares as void.

6. Asset Misappropriation:

- Fake invoices, Fake payments, Misstatement of facts, Willful omission of Financial Statement (FS) data
- Readers of FS get misled
- Company Loan by showing false growth etc.

FSA – Financial Data Analysis C Fraud Triangle (Auditing technique)

This included raising fake invoices, misappropriation of cash, payments made to non-existing employees or suppliers, theft of Inventory, or misuse of assets. It comes about in undesirable conditions when people who are entrusted to manage the assets of a company/organisation give away from it.

7. Financial Statement Fraud:

Financial statement fraud is the willful and deliberate misstatement or misrepresentation, creating a false impression and omission of financial statement data to mislead the reader of a Company's financial strength.

It diminishes the confidence of market participants and capital markets in the dependability of financial information.

- Forensic Data Analysis (FDA).
- Fraud Triangle and Fraud Risk.

Forensic Audit	**Traditional Audit**
1) Term is not certain	Term is certain
2) Extraction of facts from accounts of company to be produce in the court of Law	Examination / inspection of financial records to give true / fair view of financial statement.
3) Auditor may be called as an expert in the witness box	No such things in Financial Audit.

4) Auditing, accounting C legal law knowledge such as IPC is also required.	Only Accounting / Auditing knowledge required.

FUNCTIONS OF FORENSIC AUDIT:

- **Planning the Investigation:**

  The forensic auditor and the team will plan their investigation to meet their objectives.

- **Collecting Evidence:**

  The evidence gathered should be sufficient to prove in court the identity of the fraudster(s), reveal the details of the fraud scheme, and document the financial loss suffered and the parties affected by the fraud.

- **Reporting:**

  A forensic audit will need a written report on the crime to be given to the client so that if they desire, they can continue to file a legal case.

- **Court Proceedings:**

  During court proceedings, the forensic investigator must be present to clarify the evidence collected and how the suspect(s) were found by the team.

NEED FOR FORENSIC AUDIT:

Thus, there are a few instances on the occurrence of which an entity should direct for forensic audit like:

a) Theft of business information or where business systems have been hacked.

b) Issues identified by Whistle-Blowers.

c) Reconciliations resulted in unidentified material differences.

Balance sheet – as on Date

Management – Differences

Asset – Increase

Profit – Actual – No Impact

Bank Balance – 5 cr

Bank Balance – 5 Lakh.

d) Suspicious of fraud or illegal activity.

e) Turnover has occurred and balances are showing negative results.

Sales – Bill register – 100 cr

Bank Balance – '0'

False Bill → Sales inflate Sales done Actual but payment not realised

→ System Hacked – Business Info leaked

→ Whistle Blower – '100' FORENSIC AUDITOR

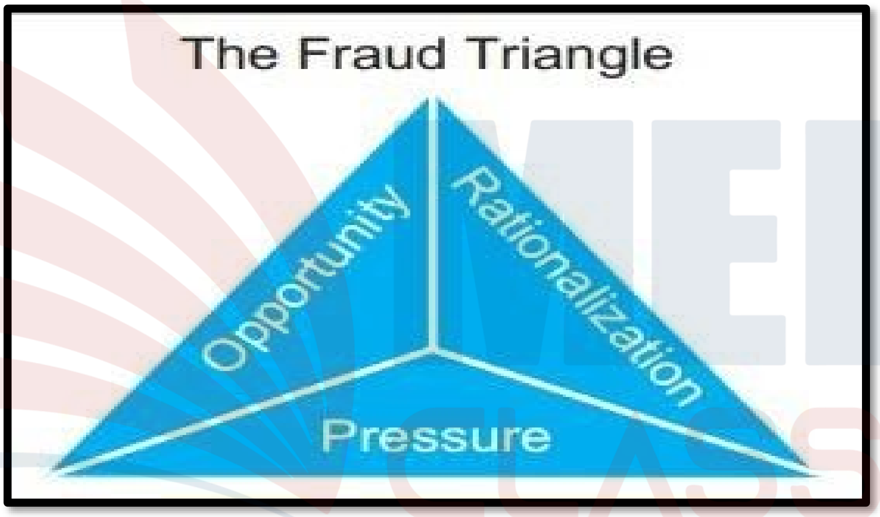
→ Differences noticed – Balance sheet

→ Sales happened but Balance showing no/negative Balance

→ Suspicious Activity – Cash Transaction

Audit Procedures:

1. Tool - Audit 'Triangle' Fraud Commit – (3)



3 Elements	**Opportunity** • Weakness in internal control • Forensic Analyst – Check for opportunities a) System check b) Daily Balances check c) Management approval d) Separation of duties

	• Whenever a payment is made it is not approved by the management – Big Payment.
3 Elements	**Pressure** ◉ Financial Pressure, Personal Pressure, Huge Expenses, Performance Pressure ◉ Personal vices/addictions such as gambling, drugs, shopping, etc. ◉ Unrealistic deadlines and performance goals. → Suppose Mr. x is an employee of Reliance Industries Ltd → He has taken huge loan for marriage of his daughter → If he doesn't pay back the loan he will have to sell the house Salary – 10 lakh Loan EMI: 15 Lakh Sales personal – Pressure to increase Sales Opportunities weakness in Internal Control
3 Elements	**Rationalization** ◉ Justification of fraudulent activity ◉ Thinking that you are doing correct though you are doing something wrong

	◉ You are doing something wrong but you may correct it afterwards

Forensic Auditor while doing forensic audit uses a tool name Forensic Triangle in order to see whether these 3 elements are present which are common when a fraud is being conducted.

SA 240 – Role of Auditor

❑ **Auditor responsibility in relation to fraud**	
Material misstatement due to error	Material misstatement due to fraud

- Reasonable assurance the FS are free from Material misstatement which are caused by Fraud / Error
- Risk of not detecting fraud is higher than to error

Forensic Audit Procedure	
FDA	**Fraud Triangle**
Data Analysis C Investigation to detect Material misrepresentation due to fraud.	Tool named 'Fraud Triangle' is used to identify 3 elements to result in a fraud

	Basically 3 elements are present when a fraud is conducted.

Investigation Methodology of Forensic Audit:

An auditor can follow a nine-step method for fact-finding in case of forensic audit engagements:

- Accept the forensic audit engagement.
- Evaluate the allegations or suspicions.
- Conduct due diligence background notes.
- Complete the preliminary stage of the investigation.
- Check the prediction assuming that there will be litigation.
- Begin with an external investigation.
- Gathering the required proofs and evidence.
- Preparing report on findings; and
- Court proceedings.

Business Frauds:

Corporate fraud consists of illegal or unethical and deceptive actions committed either by a company or an individual acting in their capacity as an employee of the company.

- Corporate fraud consists of illegal, deceptive actions committed either by a company or an individual who is an employee of the company.
- Many corporate fraud schemes are highly complicated accounting schemes used to inflate a company's apparent profits and may take years to detect.
- When massive corporate fraud is eventually discovered, it can take down even huge multinational companies with billions in annual revenues.

Why Do Corporate Frauds Happen?

a) The Desire or Perceived need to attract or Retain Investors:

b) Problems or defects with a Company's Products:

c) Major Corporate Fraud Cases in the World:

i. **Enron Company:**

One of the most notorious cases of corporate fraud is the Enron scandal. At its height, Enron, a major energy company, was raking in billions upon billions in profits. However, when the company began to face declining revenues and debt troubles, company executives hid the facts through massive accounting fraud. In the end, both Enron and its accounting firm, Arthur Andersen, went under. Thousands of employees lost their jobs, and Enron's creditors and investors lost billions.

The Enron Accounting scandal is credited with resulting in the passage of the Sarbanes Oxley Act, which required more transparency in companies' financial reporting and imposed significantly harsher penalties on any company caught for committing accounting fraud.

ii. **Waste Management:**

Waste Management, the largest garbage and recyclables collector in the United States, appeared to be one of the most financially sound companies in the United States in the early 1990s. Investors eagerly bought up the company's stock, driving its price steadily higher. However, when a New Chief Executive Officer (CEO) assumed the post in 1998, he eventually discovered that, like Enron, Waste Management previously perpetrated a multi-billion-dollar accounting fraud in an attempt to pump up its profitability numbers.

Unlike Enron, Waste Management was able, under its new leadership, to survive the resulting scandal, penalties from the Securities and Exchange Commission (SEC), USA, and a multi-million-dollar lawsuit by investors.

iii. **ZZZZ Best Company: -**

Barry Jay Minkow – Fraudster

'15' years - carpet cleaning C Restoration

Loan – Laon Repay

Tom Pagett – Company – Contract – Loan taken – Gambling

The story of ZZZZ Best, a carpet cleaning company founded by a 15-year-old, is a rags-to-riches-to-rags story. Within six years of the company's founding, its entrepreneur owner was able to take the company public, with a valuation of approximately $300 million. There was just one problem- Barry Minkow, the founder, and owner of ZZZZ Best had made up out of thin air practically all of the company's alleged "Customers". In short, engaging in a classic Ponzi scheme. Before Minkow could generate enough business to cover his fraud tracks and hopefully right the company's finances, his fraud scheme was discovered. The result was that ZZZZ Best, once an inspiring success story, went completely burst just a few months after the Company's initial public offering (IPO).

iv. Wire card Company:

One of the more recent corporate fraud cases is that of Wirecard, a payment transfer and processing company in Germany. In early 2020, accounting auditors discovered a whopping $2 billion discrepancy between the company's books and the actual money it held. Like many corporate fraud schemes, Wirecard's cooking of its books had been going on for several years before it was detected. Wirecard was forced to declare bankruptcy, and its CEO was arrested by German authorities.

v. Wells Fargo s Company:

The fraud case of Wells Fargo revealed the danger of companies putting high-pressure sales quotas on employees. The result of such a practice at Wells Fargo Bank led hundreds of its employees to open fake accounts for Wells Fargo clients. Short-term profits went up by millions, but when the widespread fraud was uncovered, the bank's fine imposed by the Securities and Exchange (SEC) ran into the billions. In addition, the bank lost hundreds, if not thousands, of clients.

vi. Nirav Modi – Gitanjali Gems, Solar Exports, Diamond SR US

vii. Satyam Scam

viii. Kingfisher

ix. Bhushan Steel

Corporate: Companies Pvt Ltd. Public Ltd.

Companies Act, 2013

Laws Relating to Corporate Fraud

Section 447 of Co's Act 2013

SFIO u/s 212 of Co's Act

Special Fraud Investigation Officers (SFIO)

As per sec – 447 of the Companies Act fraud is defined as follows:

1. Laws Relating to Corporate Fraud

- Any Act **or**
- Omission **or**
- Concealment of any factor **or**
- Abuse of position

2.

- * Any person / By any person
- * With the connivance in any matter
- * With the Intent to Deceive

3. Intent to Deceive

- Section 463 of IPC
- Deceit (+) Injury to the person deceived
  - Economic Loss Movable / Immovable property
  - Injury to Body, health, mind, reputation

4. To gain undue advantage from or to injure the interest of the shareholder of the company or its creditors

5.

Wrongful Gain	Wrongful Loss
Gain from Property	Loss from Property

Punishment

- 6 month or 10 years
- 10 Lakh or 1% of Turnover whichever is lower
- Penalty > Amount of Fraud upto 3 times
- Public interest prisonment upto 3 years
- Cognizable, non-bailable, non-compoundable

Section 446A of the Act lays down five factors to be considered by the Court while deciding the amount of fine or imprisonment under the Act:

a. size of the company;

b. nature of business carried on by the company;

c. injury to the public interest;

d. nature of the default; and

e. repetition of the default

Standard of Proof:

Section 447 of the Act provides for maximum imprisonment for five years. The standard of proof is 'beyond reasonable doubt'. Recently, the SC in the matter of the Latest State of Maharashtra explained the term 'reasonable doubt' as "a mean between excessive caution and excessive indifference to a doubt, further it has been elaborated that reasonable doubt must be a practical one and not an abstract theoretical hypothesis… "

Latest Developments:

SEBI has amended the SEBI (Listing Obligations and Disclosure Requirements-LODR) Regulations, 2015 with effect from October 08, 2020, to provide that in case of initiation of a forensic audit, (by whatever name called), the following disclosures shall be made to the stock exchanges by the listed entities:

1. The fact of initiation of forensic audit along-with name of entity initiating the audit and reasons for the same, if available;

2. Final forensic audit report (other than for forensic audit initiated by regulatory / enforcement agencies) on receipt by the listed entity along with comments of the management, if any

Red Flags for Fraud:

- Managers and employees are responsible and should be aware of the red flags for fraud.
- These are warning signs that may indicate that fraud risk is higher without any evidence that fraud occurring.

Employee Red Flags:

- Employee lifestyle changes: expensive cars, jewellery, homes, clothes.
- Significant personal debt and credit problems.
- Behavioral changes- These may be an indication of drugs, alcohol, gambling, or just fear of losing the job.
- High employee turnover, especially in those areas which are more vulnerable to fraud.
- Refusal to take a vacation or sick leave.
- Lack of segregation of duties in a vulnerable area.

Management Red Flags:

- Management frequently overrides internal controls.
- Management decisions are dominated by an individual or small group.
- Managers display significant disrespect for regulatory bodies.
- Policies and procedures are not documented or enforced.

- Weak internal control environment.
- Manager/Senior level manager has no intention to deceive but he has done something

  →Weakness in internal control

  →Pressure on Employees to commit fraud
- An excessive number of checking accounts; frequent changes in banking accounts.
- An excessive number of year-end transactions; unnecessarily convoluted transactions.
- Photocopied or missing documents

FINANCIAL FORENSIC:

- ❖ Criminal Activity involving Money
- ❖ Financial crime investigation

Examining the financial records of the company to gather evidence of loss of money/asset for use in the court of Law/Legal Proceedings.

A financial forensics professional might work on:

Financial theft:

Financial theft occurs when a customer, an employee, or another individual steals money from an organisation. An employee, for example, might take money from a cash register. A financial forensics analyst studies the event, looking for evidence of theft in documents such as receipts, payments or profit-or-loss statements.

Securities fraud:

Securities fraud is a type of white-collar crime that typically occurs when someone presents false information to an investor. For example, a stockbroker might give misleading advice to convince a client to invest in a certain company.

Money laundering:

Money laundering is the process of making money earned through illegal methods look legal. For example, someone might take stolen cash and invest it into a cash-based business, such as a restaurant.

Corporate valuation disputes:

A financial forensics professional might analyse a business to determine its value.

Tax evasion:

Tax evasion occurs when a person or organisation avoids paying their taxes.

Example of Forensic Account/Financial Forensic

Financial Theft
Theft of Money

Security Theft Shares
- Harshad Mehta
- Shares of the company purchased in bulk causing price to inflate
- Leading to burst of Bubble

Money Laundering
Conversion of illegal money to legal money by using intermediaries or companies involved in such transaction

Corporate valuation disputes
Twitter vs Elon Musk
Reliance vs Future Retail

Tax Evasion
Tax Department might use the help of Financial Forensic Accountant to analyze a tax evasion

Forensic Audit Techniques:

Forensic Accounting/Auditing is a type of accounting that cross-checks a business's various financial records to find any indication of fraud being committed. It also provides an in-depth analysis of all of the business›s financial books, which could be presented in the court of law as evidence. Forensic accountants can be considered detectives in the economic and business field. These people go through every recorded transaction and try to find any fraudulent or illegal activity within the industry.

Qualities a Forensic Accountant

- Logical Mind
- Detail Attention
- Moral Principles
- Question Mind
- Spontaneous
- Accounting Knowledge
- Legal Knowledge

Investigating Technique of Forensic Accountant

- ✓ Public Document Reviewing – B/S C P C L
- ✓ Conducting Detailed Interview
- ✓ Gathering Information from Sources (Reliable)
- ✓ Analysing Evidence Gathered – Legal Court

✓ Conducting Surveillance – Detective / CID / CCTV
✓ Going Undercover – Barber, Begger to gather info
✓ Analysing the Financial Evidence

Audit Technique:

Balance Sheet of RIL

Cash Balance – 5 cr

Creditor – 40 cr

Debtor – 50 cr

Reliable – RIL – Forensic Audit

Ethical Consideration & Code of Conduct

WHAT IS ETHICS

Moral Principle that govern a person behavior

US Equal Employment Opportunity Commission (EEOC)

1. Harassment s Discrimination in the Workplace

- **Harassment**
- **Discrimination**

Age → 40 years or above
Disability → Accommodation C equal treatment
Equal Pay → Regardless of religion, age, sex etc.
Pregnancy → Proper care to pregnant person i.e. maternity leave etc.
Race → Black or White
Religion → Hindu/Muslim – Equal treatment
Sex C Gender → Employee treated equal base on their gender

2. Health & Safety in the Workplace

Occupational Safety C Health Administration (OSHA) [10 violation] [2018]

Fall Protection → He gets injured due to some sharp edges of furniture
Hazard Communication → Harmful Chemical
Scaffolding → Weight how much C what
Respiratory Protection → Covid/Chemical – Bhopal gas tragedy
Lockout Tagout → Lockout due to gas
Powered Industrial Trucks → Safety from powered Truck/Dumper

Ladder → Ladder how much weight
Electrical wiring method → wiring, circuit, voltage mentioned etc.
Machine Guarding → Fencing/Guarding of Machine
Electrical general requirement → Room – machine leakage water current

Whistle Blowing OR Social Media Rants

3. Firing of Employee Based on Online Post

Whistle Blower

Social Media Defaming Post

- ✓ Employees should be encouraged for raising awareness of workplace violations online.
- ✓ If harmful to the company, then punishable If Bad then Punish - If Good then Promote.

4. Ethics in Accounting Practices – 'Good/Bad'

False/Willful misrepresentation of Fact
Unethical means of accounting – "cooking the books" ⬇ Giving wrong information to the shareholders/creditors/investors
Sarbanes Oxley Act 2002 – Financial Reporting Requirement

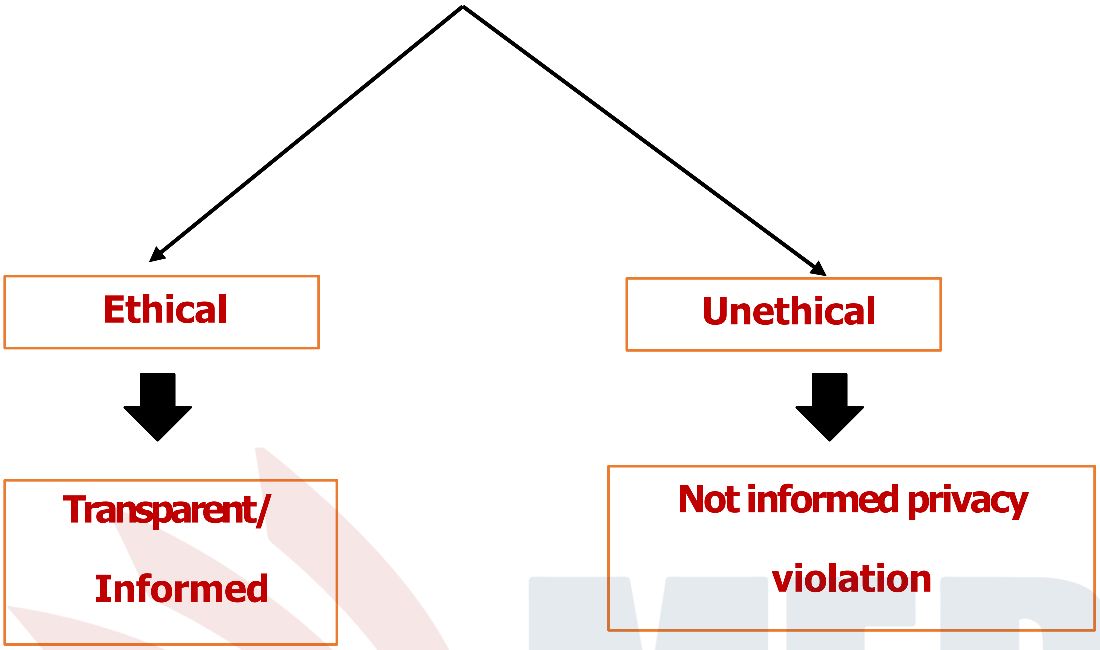
5. Non-Disclosure and Corporate Espionage

Non-Disclosure agreement
Stealing company information and giving to competitors
Stealing client info/data and distributing leading to penalties on company
Agreement with the employees not to disclose client info outside

6. Technology and Privacy Practices

- ✓ Employer can monitor employee activity.

- ✓ Efficiency C Productivity



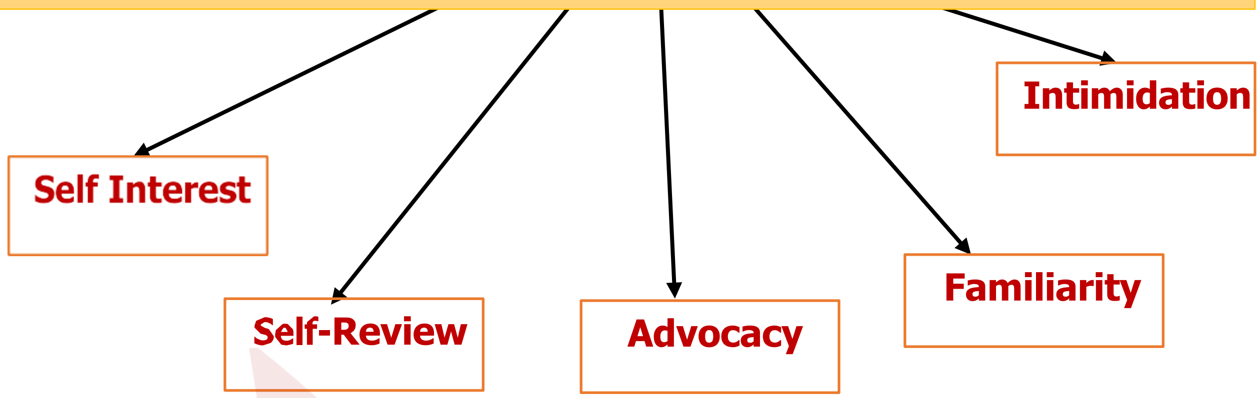
7. Auditor

- ✓ Reasonable Assurance that the FS are free from any material misstatement due to fraud/error.

- ✓ Auditor should accept the audit engagement when he has assurance that there is no limitation on his work .

- ✓ Auditor should always follow fundamental principles of ethics or Code of Ethics which have been laid down by regulatory bodies.

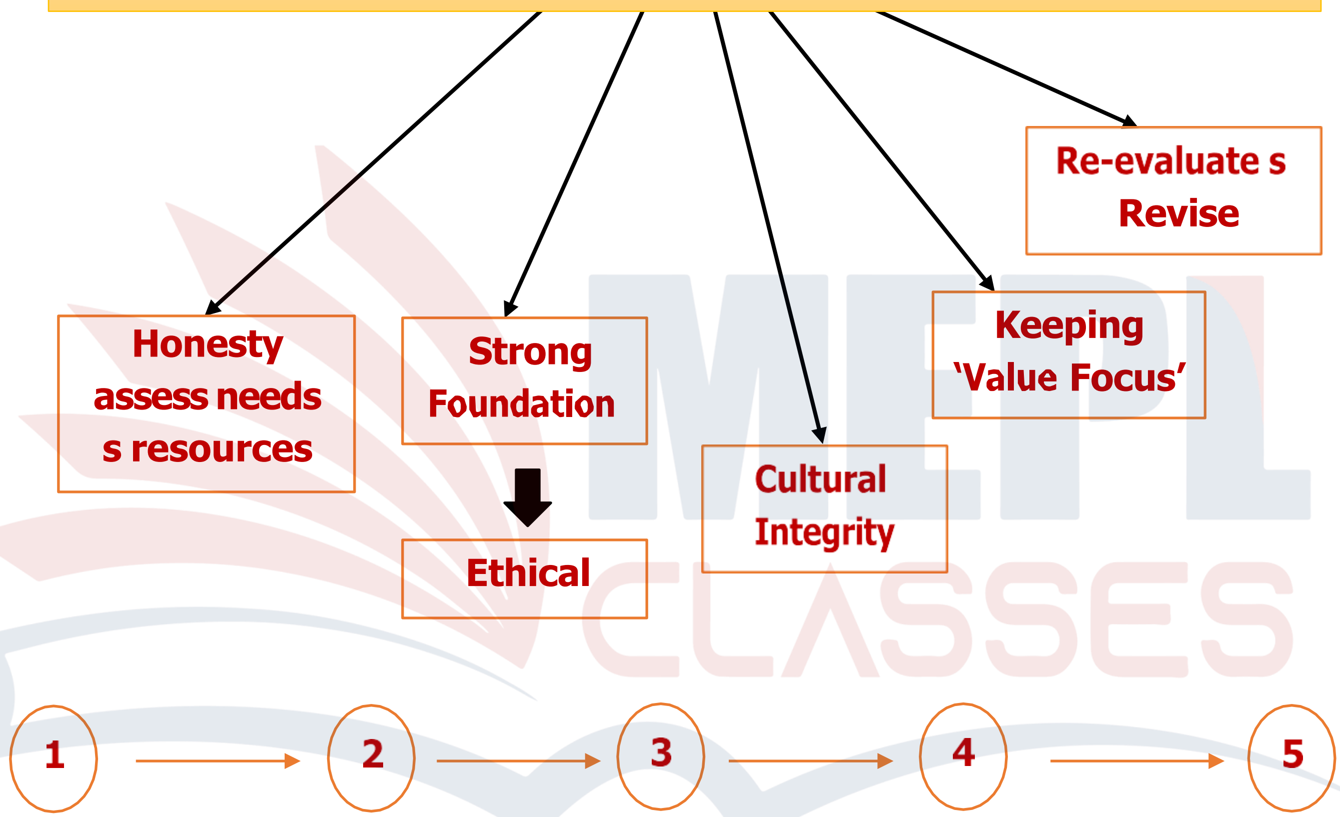
Threats by which Auditor may not accept the engagement



Self Interest	Auditor hold direct/indirect financial interest in the company
Self-Review	Internal Auditor or Statutory Auditor cannot be same Auditor may not give opinion or review his own work.
Advocacy Threat	Auditor is a spokesperson of the company so cannot give opinion on the matter of company or his opinion cannot be relied upon
Familiarity Threat	Auditor is too familiar or close to the employees or management of company so his opinion may be affected or leaked by the employees/management.

Intimidation Threat	Threat to himself or family member to leave the audit or change the audit

Steps to Reduce Ethical Risk



Step - 1	**Honesty Assess needs s resources** * Threat C Vulnerability analysis * Existing strength of the company

	* Risk Assessment Gap Analysis → Programe → Report Planning → Analysis → Reporting * How to gather information **Snapshot** **[Random third sampling]** ↓ **Small group** **Survey** **[Proper analysis by party]** ↓ **Large group**
Step – 2	**Strong Foundation** * Ethical standards which the company should follow * All the labours should wear helmet * There should be shifting of worker after every 8 hours * Top management should work in the floor assigned * Whistle blower policy.

	Not Follow w **Punished, Suspend, Fine** **Follo** **Promotion**
Step – 3	**Cultural Integrity** * Top-Down approach * Leaders should lead from front by showing showcasing high cultural values to employee. * Preach what you follow: E.g. Ratan Tata of Tata group vs. Vijay Mallya of Kingfisher **Character is Paramount** → **Even at home/Preach ethical values** **Leadership happens at all Level** → **Manager – Supervisor to their junior**

Step – 4	**Keeping 'Value Focus'** * Value should be kept always high ↓ Vision C Mission of the company * Even in bad situation company should not loose its value. * Reward system for ethical behavior * Punishment for unethical behavior even if it is good for company.
Step – 5	**Re-evaluate s Revise** * Yearly – we are following it correctly or not * Re-evaluate everything to check whether it is working properly * Reporting C analyzing.

Challenges for implementing Ethics Policy

Resistance from Employees	Cost of Training s Implementation	Inability to determine the ROI

→ May not adapt to change	→ Regular training due to 5 steps mentioned very highly costly	→ Cost vs Benefit difficult to determine
→ Must be rewarding	→ Separate HR team is required	• It is very difficult to measure behavior in monetary term
		• Chances of fraud reduce
		• Shareholder will have blind faith in company
		• Credit rating will improve

Code of Conduct in Forensic Audit

- Association of Certified Fraud Examiners (ACFE) Founded 1988 by Joseph T Wells.
- CFE – is a certification awarded by the ACFE like CA C ICAI.
- Standards to be followed by all the Certified Fraud Examiners (CFE)

Standard of Professional Conduct

A. Integrity s Objectivity
B. Professional Competence
C. Due Professional Care
D. Understanding with Client or Employer
E. Communication with Client or Employer
F. Confidentiality

Standard of Examination

A. Fraud Examination
B. Evidence

Standard of Reporting

A. General
B. Report Content

Standard of Professional Conduct

A. Integrity s Objectivity
• CFE shall conduct themselves with integrity
• Integrity shall not be compromised over no matter what

- Before accepting audit, CFE shall look for potential threat or conflict of Interest
- CFE shall maintain objectivity in discharging their duties
- CFE shall not conduct any disrespectful act
- CFE shall not make any false statement when testifying under oath in the court of law or other forum

B. Professional Competence

- Shall be competent and not accept consignment where competence is lacking
- CFE shall maintain the minimum program of continuing professional education required by the ACFE

C. Due Professional Care

- Profession Skepticism
- All qualities of Forensic Accountant

Logical Mind	**Detail Attention**	**Moral Principles**	**Question Mind**

Spontaneous	Accounting Knowledge	Legal Knowledge	

- Planning, Detailed review, Team

D. Understanding with Client or Employer

- CFE shall understand the client about the scope C limitation of the fraud
- Check of Familiarity Threat – Client is in close relation – Familiarity Threat
- He should sit with client and understand the detailed fraud report

E. Communication with Client or Employer

- CFE should communicate significant findings to the client or employer
- Sit with client and communicate the findings
- Employer will take Decision whether do case or not

F. Confidentiality

• CFE should not disclose confidential information obtained during audit without taking permission from the authority
• Non-Disclosure agreement with the team/audit team

Standard of Examination

A. Fraud Examination
• He should conduct the examination with the knowledge of Accounting, Auditing C knowledge of legal proceeding
• He should have professional – professionally conduct examination
• Attention to details – Efficient examination of the evidence
• Examination keeping in mind that he may called as a witness in legal proceeding
B. Evidence
➢ CFE should have control C administration on the documents, data C others which he has collected during the course of examination.

Standard of Reporting

A. General

Report
- ORAL
- written

No prescribed format

Not misleading

B. Report Content

- Based on evidence that is sufficient
- Legal guilt or innocence i.e. no judgement should be passed

CODE OF ETHICS OF CFE

A. CFE shall demonstrate a commitment to professionalism C diligence in the performance of his/her duties

B. CFE shall not engage in any illegal/unethical conduct

C.	CFE shall exhibit high level of integrity C accept the consignment for which there is reasonable assurance of professional competency
D.	CFE shall comply with the order of the court and shall not give wrong testimony
E.	CFE shall not reveal any confidential information without authorization
F.	CFE shall reveal all material matter discovered during audit to the client
G.	CFE will have proper documentation and proper

FRAUD

Fraud is a deceptive action intended for personal or financial gain and a certified fraud examiner is a highly qualified professional who investigates cases of:

- Criminal fraud
- Civil fraud

Embezzlement | **Payroll Fraud** | **Skimming** | **Expense Report Fraud**

E.g.

ATM - Card insert – Pin – Money withdraws

↓

Scanner/Detector

↓

Personal Information / Data Store

Why there is a need for Forensic Accountants?

- Forensic Accounting is the specialty practice area that describes engagements that result from actual or anticipated frauds, disputes, or litigations.
- The growing number of regulators, the administrative agencies will demand the services like forensic reviews. Cost Accountants are going to find themselves more involved in what is essentially a type of forensic practice.
- Nearly 40 percent of the top 100 American accounting firms are expanding their forensics and fraud services.

Pre-requisite of a skillful Forensic Accountant:

a) Dave Cotton, a qualified CFE has greatly defined the attitude the person should maintain while investigating Fraud and Forensic Cases. He said: 'Many fraud perpetrators aren't as clever at concealing fraud as most people probably think. If CFEs simply remain alert and maintain a high degree of professional skepticism many potential frauds are easy to find'.

b) A good Forensic Auditor requires immense knowledge of the finance aspects along with a good understanding of internal financial controls as identification of weak control can help to easily catch out the areas where fraud can be carried out.

Some of the Companies which were in news in recent past for the wrong reasons:	
1.	**Vakrangee –** No one knows what's wrong with the Company, but still the stock prices kept on falling.
2.	**Manpasand –** Alleged Tax credit claim fraud (Fake invoices exchanged in grey market).
3.	**LEEL –** It is alleged that Promoters just took out the money after selling a business unit.
4.	**Gitanjali –**

	Fake letter of credit.
5.	**Ero, Cox and kings –** It was alleged that Despite having cash, company defaulted on NCD.
6.	**DHFL –** It is alleged that borrowed funds were used to lend to shell companies owned by operator.
7.	**ILsFS–** Huge bonuses and dividend pay-outs to promoters were alleged.
8.	**Yes Bank –** Alleged non-disclosure of provisions is been the issue and power of cantered in the hand of one man knew and he was asked by regulators to leave.
G.	**HEG–** A 20 million USD bonus was given to the CEO when shareholders lost more than 80% of value.
10.	**CG Power –** It is alleged that billion dollars taken out via transactions.
11.	**TATA Sons-** The Board aligned to the majority shareholder, gave Cyrus Mistry a glowing performance review only to sack him a few months later.
12.	**Infosys–** The Board first played supplicant to Chief Executive Officer Vishal Sikka, then to former promoter NR Narayan Murthy. Investors paid

	the price for unstable leadership, and even today, investigations into acquisitions have not been shared with all the stakeholders.
13.	**Axis Bank–** The Board seemed unquestioning of Managing Director and Chief Executive Officer Shikha Sharma, but the regulator wanted her go.
14.	**ICICI Bank–** The Board appeared like a deer in the headlights, dazed by the celebrity of MD C CEO Chanda Kochhar, allowing her continued presence in the company, even as she was being investigated for alleged nepotism.
15.	**Fortis–** Promoters held sway, the board turned a blind eye to many suspicious transactions, and finally shareholders booted them out.

SPACE FOR NOTES

CHAPTER – 18 PREVENTION OF MONEY MONEY LAUNDERING

What is Money Laundering?

The process of conversion of illegal money or dirty money
to legal money or clean money
is called money laundering

BLACK MONEY

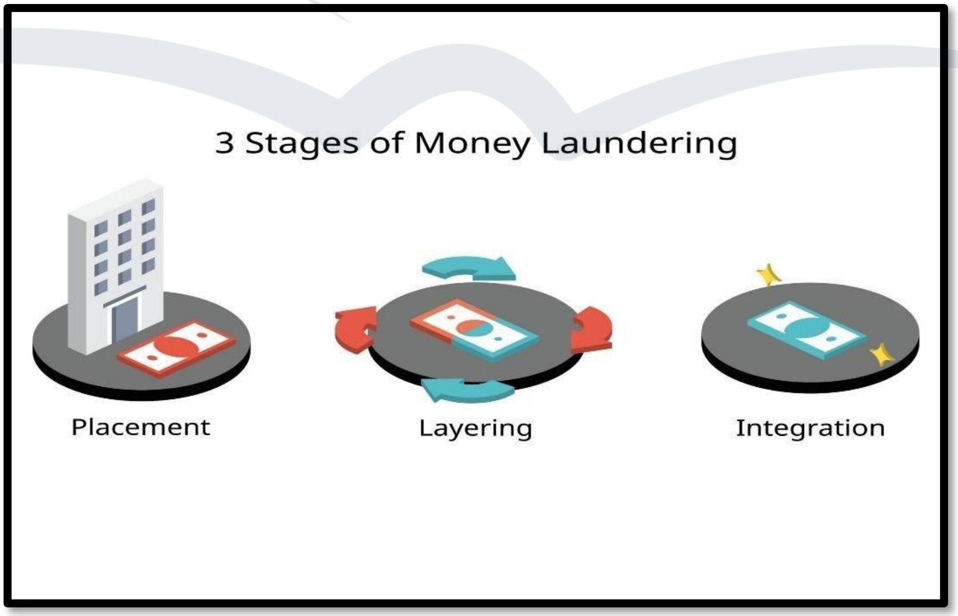
BLACK MONEY

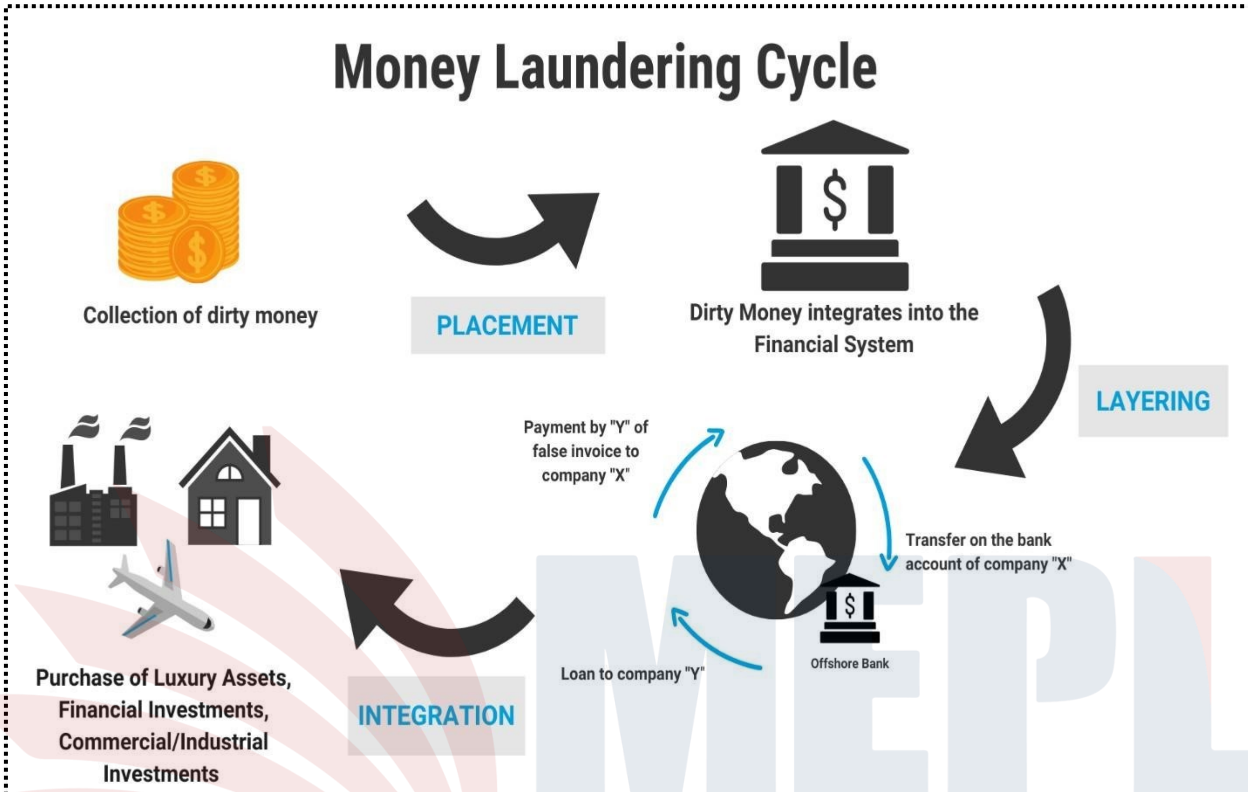
- **LEGITIMATE SOURCE**
  - **INCOME EARNED FROM LAWFUL ACTIVITIES BUT ON WHICH TAX HAS NOT BEEN PAID**
- **ILLEGITIMATE SOURCE**
  - **TERRORIST ACTIVITY , DRUGS SMUGGLING , HUMAN TRAFFICKING , ILLEGAL ACTIVITIES , CRIMINAL ACTIVITIES**

HAWALA SYSTEM

• The process of transferring of money
• From one place to another
• Without the use of standard or regular channels
• Such as banking or otherwise
• With the help of agent
• (Who is engaged in the business of hawala)
• Is known as hawala system

Process of Money Laundering





What is Placement?

- The process of placing the money
- by dividing the money into small packets
- and placing it into cash-based business
- or placing it into the offshore business
- without disclosing the true identity

- of the owner of the fund.

TAX HAVEN

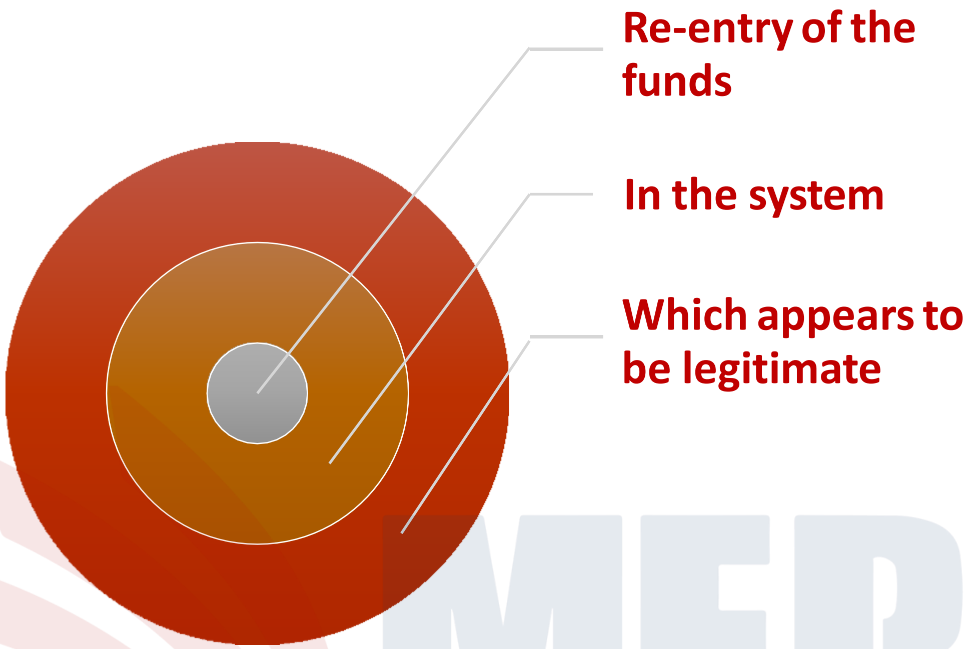
- Some countries do not have any info sharing agreement with India.
- For example –
- Cayman Islands ,
- Panama Island ,
- Switzerland

- These funds are placed in the banks of these tax havens to disassociate the funds from its true owners

What is Layering

- Separating funds from the source
- Converting illegal money into legal money
- By using complex financial transactions
- Which makes it difficult
- To identify the source of fund
- Basically, disguising the trail
- To fail the suspected transactions getting identified.

What is Integration?



Money Laundering History

- The 1998 United Nations Convention against illicit traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention of 1998), provided a comprehensive legal definition of money laundering. This definition has formed the basis of subsequent legislations on Money Laundering Laws of various countries;

- The Basle statement of principles, enunciated in 1989, outlined basic policies and procedures that banks should follow in order to assist the law enforcement agencies in tackling the problem of money laundering; and

- The Financial Action Task Force on money laundering (FATF), 1989 made 40 recommendations, which provide the foundation for comprehensive legislation to combat the problem of money laundering. The recommendations were classified under various heads. Some of the important heads are: -

  a) Declaration of laundering of moneys earned through serious crimes should be treated a criminal offence;

  b) to work out modalities of disclosure by financial institutions regarding suspicious transactions;

  c) Confiscation of the proceeds of crime;

  d) declaring money laundering to be an extraditable offence; and

  e) promoting international cooperation in investigation of money laundering.

- FATF was formed by G7 countries in 1989.
- It is a global watchdog for money laundering C terrorist financing.
- It is a inter-governmental body that sets certain international standards.
- That aims to prevent the illegal activities which harm the society.
- The FATF is a policy making body.
- That with the help of various initiatives and recommendation.
- Brings national reform.

PREVENTION OF MONEY LAUNDERING ACT, 2002

PMLA , 2002

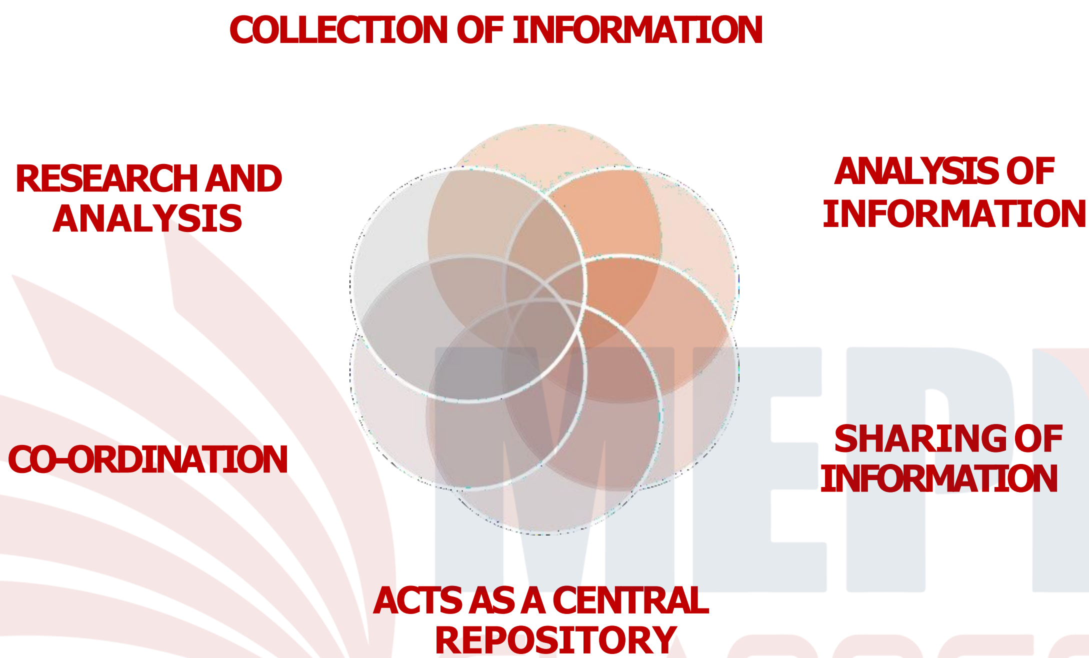
- 17th January , 2003
- 1st July, 2005
- Ten Chapters
- 75 sections
- Act number 15 of 2003.

Financial Intelligence Unit - India (FIU-IND)

- It was set up by the Government of India on 18th November, 2004.
- It is a central, national agency responsible for
- Receiving, processing and disseminating
- Information relating to suspected financial transactions

Bank/ FI- Suspicious Transaction → **Report** → **FIU – INDIA / ED**

Financial Intelligence Unit - India (FIU-IND)



ENFORCEMENT DIRECTORATE

- It is an investigation agency which investigates economic crisis and foreign exchange laws violation.
- ED was entrusted with the enforcement of PMLA w.e.f 1st July, 2005.
- The statutory functions of the Directorate include enforcement of following Acts:

a) The Prevention of Money Laundering Act, 2002 (PMLA)

b) The Foreign Exchange Management Act, 1999 (FEMA)

c) The Fugitive Economic Offenders Act, 2018 (FEOA)

Preamble to PMLA, 2002

- "An Act to prevent money-laundering and to provide for confiscation of property derived from, or
- involved in, money-laundering and for matters connected therewith or incidental thereto.

Proceeds of Crime - Section 2(1)(u)

- any property derived or obtained,
- directly or indirectly by any person
- as a result of criminal activity relating to a scheduled offence
- where such property is taken or held outside the country, then the property equivalent in value held within the country or abroad.

SCHEDULED OFFENCE - Section 2(1)(y)

Scheduled Offence means

- The offences specified under Part A of the schedule
- The offences specified under Part B of the schedule if the total value involved is 1 crore rupees or more
- The offences specified under Part C of the Schedule .

PROPERTY - SECTION 2(1)(v)

Property means

- Any Property
- Whether corporeal or incorporeal
- Movable or immovable
- Tangible or intangible
- And includes deeds s instruments evidencing title to
- Or interest in such property or assets wherever located

SECTION 3

Whoever directly or indirectly
Attempts to indulge
Or knowingly assists
Or knowingly is a party
Or is actually connected in any process or activity
Connected with the proceeds of crime

Including

- **Concealment**
- **Possession**
- **Acquisition**
- **Use**
- **Projecting as untainted property**
- **Claiming as untainted property**

- Shall be held guilty.
- Of offence of money – laundering

SECTION 4 - PUNISHMENT UNDER PMLA

		RIGOROUS IMPRISONMENT	±	FINE
GUILTY OF OFFENCE COMMITTED UNDER SECTION 3	MINIMUM	3 YEARS	+	FINE
	MAXIMUM	7 YEARS	+	FINE
GUILTY OF OFFENCE COMMITTED UNDER PARA 2 OF PART A OF NDPS	MINIMUM	3 YEARS	+	FINE
	MAXIMUM	10 YEARS	+	FINE

SECTION 45 - OFFENCES TO BE COGNIZABLE AND NON-BAILABLE

NO PERSON ACCUSED UNDER THE ACT SHALL BE RELEASED ON BAIL OR BY BOND UNLESS –

- **PUBLIC PROSECUTOR HAS BEEN GIVEN AN OPPURTUNITY TO OPPOSE THE APPLICATION AND**
- **PUBLIC PROSECUTOR OPPOSES THE APPLICATION AND**
- **THE COURT IS SATISFIED THAT THERE ARE REASONABLE GROUNDS THAT THE PERSON ACCUSED IS NOT GUILTY OF SUCH OFFENCE AND HE IS NOT LIKELY TO COMMIT ANY OFFENCE WHILE ON BAIL**

A PERSON

- UNDER THE AGE OF 16 YEARS, OR
- WORKMAN, OR
- SICK OR INFIRM, OR
- ACCUSED OF MONEY LAUNDERING AND
- SUM INVOLVED IS LESS THAN 1 CRORE

MAY BE RELEASED ON BAIL ON THE DIRECTION OF COURT

- This section has now become void as per the judgement of the Supreme Court.
- However, after the judgement the section was again amended – so it has become a debate whether the section is applicable or not.

As per RBI Master Circular – Reporting Entity means all

- **Scheduled Commercial Banks**
- **Regional Rural Banks**
- **Local Area Banks**
- **Urban Co-operative Banks**
- **State and Co-operative Banks**

Reporting Entity means,

- All India Financial Institutions.
- All NBFC
- All Payment Service Providers (PSP)

- All Authorised Persons
- Money Transfer Agents

SECTION 12 - OBLIGATION OF BANK/ FI AND INTERMEDIARIES

Every reporting entity shall

- **(a) Maintain a record of all the transactions (including information relating to transaction)**
- **(b) Furnish to the Director within such time as may be prescribed , information related to such transaction**
- **(c) Maintain record of documents evidencing identity of its clients**

- Section 12(3) states that the records referred to in clause (a) of sub-section (1)shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

KYC ELEMENTS

Shall include following four key elements:

- **Customer Acceptance Policy**
- **Customer Identification Procedures**
- **Monitoring of transactions**
- **Risk Management**

RISK ASSESSMENT BY REPORTING ENTITY IN RELATION TO MONEY LAUNDERING

- Carry a Money Laundering or Terror Financing risk assessment on a periodic basis
- Risk Assessment shall be properly documented
- The outcome of the assessment shall be available to competent authority
- **Proper monitoring of "Risk Based Approach"**
  - **RE shall monitor the control and enhance them if needed**

ATTACHMENT OF PROPERTY → **DEPUTY DIRECTOR/ DIRECTOR**

- **ANY PERSON IS IN POSSESSION OF ANY PROCEEDS OF MONEY LAUNDERING**
- **SUCH POSSESSION HAS BEEN CHARGED OF HAVING COMMITTED A SCHEDULED OFFENCE**
- **SUCH PROCEEDS OF CRIME** → **CONCEAL / TRANSFER**

PROVISIONALLY ATTACH SUCH PROCEEDS OF CRIME / SUCH PROPERTY BY ORDER IN WRITING FOR A PERIOD NOT EXCEEDING 180 DAYS.
PERSON CAN ENJOY THE PROPERTY BUT CANNOT TRANSFER THE PROPERTY TO ANY THIRD PARTY
DIRECTOR / DY. DIRECTOR SHALL
FILE A COMPLAIN TO THE
ADJUCATING AUTHORITY WITHIN 30 DAYS
FROM THE DATE OF ATTACHMENT

ADJUCATION (SECTION 8)

SEC 8 (1)
IF THE ADJUCATING AUTHORITY HAS REASONS TO BELIEVE THAT SUCH PERSON HAS COMMIITED A OFFENCE U/S 3.
SERVE A NOTICE WITHIN 30 DAYS
• TO INDICATE • SOURCE OF INCOME • HOW THE PROPERTY WAS ACQUIRED • SHOW CAUSE WHY THE PROPERTY SHOULD NOT BE CONFISCATED
SECTION 8(2)
• REPLY • HEARING AGGREIVED PERSON C DIRECTOR • TAKING INTO ACCOUNT ALL INFORMATION
RECORD THE FINDINGS

SECTION 8(3)

- **SHALL CONFIRM IN WRITING**
  - **THE ATTACHMENT**
  - **i.e, CONFISCATION**
- **CONTINUE THE INVESTIGATION**
  - **FOR A PERIOD**
  - **NOT EXCEEDING 365 DAYS**

<u>SECTION G</u> - RIGHT OF THE PROPERTY VESTED WITH THE CENTRAL GOVERNMENT (CG)

AUTHORITIES UNDER THE PMLA

- **DIRECTORS/ ADDITIONAL DIRECTORS / JOINT DIRECTORS**
- **DEPUTY DIRECTOR**
- **ASSISTANT DIRECTOR**
- **SUCH OTHER CLASS OF OFFICERS AS MAY BE APPOINTED**

JURISDICTION

- TERRITORIAL AREA
- CLASSES OF PERSONS
- CLASSES OF CASES
- ANY OTHER CRITERION AS CG MAY SPECIFY

SEARCH AND SEIZURE

- **SECTION 16**
  - **ENTER PROPERTY FOR SEARCH AND SEIZURE**
- **SECTION 17**
  - **SEARCH AND SEIZURE**
  - **ARREST ANY PERSON**

UNLAWFUL ACTIVITIES PREVENTION ACT, 1967.

- CESSION / SECESSION OF THE TERRITORY OF INDIA OR A PART
- DISRUPTION OF TERRITORIAL INTEGRITY OR SOVREIGNITY.
- DISAFFECTION AGAINST INDIA

CONFISCATE / SEIZE / ATTACH

SPACE FOR NOTES