RAGHAV ACADEMY

CMA FINAL GROUP- IV

PAPER -19

COST AND MANAGEMENT AUDIT

HAND WRITTEN NOTES AND PRACTICALS

BY

CMA UJJAWAL JAIN

THIS BOOK IS DEDICATED TO MY BELOVED PARENTS

MR. ARUN KUMAR JAIN

&

MRS. SEEMA JAIN

THEY ARE MY SUPER GOD

GOD IS GREAT

AND PARENTS ARE GREATEST

A VERY

PRECIOUS THANKS TO

CA RAGHAV GOEL

&

SAKSHI AGARWAL

{ WHOSE BLESSINGS IS ALWAYS WITH ME }

AN EXTREMELY MOTIVATIONAL SONG DURING MY CMA JOURNEY

पिघला दे ज़ंजीरें
बना उनकी शमशीरें
कर हर मैदान फ़तेह ओ बंदेया
कर हर मैदान फ़तेह

घायल परिंदा है तू, दिखला दे ज़िन्दा है तू
बाक़ी है तुझमें हौसला
तेरे जुनूँ के आगे, अम्बर पनाहें माँगे
कर डाले तू जो फैसला
रूठी तकदीरें तो क्या, टूटी शमशीरें तो क्या
टूटी शमशीरों से ही हो
कर हर मैदान फ़तेह, कर हर मैदान फ़तेह
कर हर मैदान फ़तेह रे बंदेया
हर मैदान फ़तेह

BASICS OF COST AND MANAGEMENT AUDIT.

→ Nature of Cost Audit :

① Cost Accounting is Process of identification, classification, Measurement, and assignment of Costs to various cost objects.

② Preparation and Presentation of Cost Records and Cost Statements is the Responsibility of the Management.

③ Cost Accounting Standards are Guidelines for the Management that Specify the cost Accounting Treatment for various cost elements, Minimum disclosure Requirement and Ensure the Comparability, consistency, and Completeness of Cost Records.

④ The Institute of "COST ACCOUNTANTS" of India, defines the Cost Audit as "a System of Audit introduced by the Government of India for the review, Examination and appraisal of the Cost Accounting records and attendant information, required to be maintained by Specified Industries.

⑤ Cost Audit is an Independent Examination of Cost Statements, cost Records and other related information of an entity.

⑥ Cost Auditing Standards Provides Guidance to the Cost Auditor through Each Step of the Audit Process with Regard to the Audit Procedures to be followed, Responsibility of the Cost Auditor and Cost Reporting.

→ Origin of Cost Audit :

① In India, methods and techniques of Cost Accounting and Audit of Cost Accounts can be Traced back to Pre-independence era when a large number of firms given contracts by the Government of India on Cost Plus basis.

② Then the Government started Verifying and investigating into the Cost structure of Such firms.

③ This Trend continued on a large Scale during world war II that led to the Recognition of Cost as a distinct concept not only in India but also in the industrial economies of the world.

④ Then the Institute of Cost and works Accountants of India was Set up in 1944 with the objectives of Promoting, Regulating and developing the Profession of Cost Accountancy in the country, which incarporated as a Statutary body by an Act of Parliament in 1959.

⑤ Now our Institute is named as "Institute of Cost Accountants of India".

→ Genesis of Cost Audit :

History of The Institute of Cost Accountants of India :

① In 1944, Institute of Cost and works Accountants of India was established under the Companies Act 1913 as a limited Company.

② In 1959, The Institute of Cost and works Accountants of India (ICWAI) was established under Cost and works Accountant Act, 1959.

③ In 2012, The Institute of Cost and works Accountants of India (ICWAI) was renamed as "The Institute of Cost Accountants of India (ICAI).

History of Cost Audit :

① In 1965, Cost Audit was first introduced in India with the Introduction of Section 233B of Companies Act 1956 for Cost Audit and Section 209(1)(d) for maintenance of Cost Records.

② In 1965-2008, 44 industries were covered under Cost Record Maintenance and Cost Audit.

③ In 2008, An Expert Group set up to Study the Existing Cost Audit mechanism.

④ In 2009, An Expert Group Submitted its report to C.G.

(5) In 2011, Introduction of Mandatory Cost Audit of Cost Records maintained by the Companies under Companies Act 1956 for manufacturing, Minning and Processing operations depending on limits of Turnover and limits of Net worth and issue of Compliance certificate by the Cost Accountants.

(6) In 2014, New Companies (cost Records and Audit Rules), 2014 issued under Companies Act, 2013.

→ Section 148 of Companies Act, 2013 :

(1) The Central Government may by an order, in respect of Such class of companies engaged in the Production of Such Goods or providing Such Services as may be Prescribed to maintain Records relating to the utilisation of Material, labour and other cost.

(2) Such Cost Records shall be Audited by a Practicing Cost Accountant if the Turnover of Specified Company exceeds Prescribed Turnover.

(3) The Rights, duties and obligation of Cost Auditor are Same as of Statutory Auditor.

(4) Cost Auditor after completion of Cost Audit will Submit his Report to the BOD in CRA-3 form.

(5) BOD will file copy of Cost Audit report in form no. CRA-4 along with full information and Explanation within 30 days from Receipient of Cost Audit Report, to the Central Government.

(6) Central Government has Power to demand any further information or explanation, if necessary.

(7) All the disqualification of Cost Auditor are Same as of Statutory Auditor.

(8) All the Penalties are Same as in case of Statutory Auditor.

→ Objectives of Cost Audit :
The objectives of Cost Audit are as follows :

1. Verification of Cost Accounts.
2. Ensuring that the Prescribed Procedures of Cost Accounting Records rule are followed or not.
3. Detection of Errors and Fraud.
4. Verification of the Cost.
5. Determination of Inventory valuation.
6. Facilitating the fixation of Prices of Goods and Services.
7. Periodical Reconciliation between Cost Accounts and Financial Accounts.
8. Ensuring optimum utilization of human, physical and financial resources of the enterprise.
9. Detection and correction of abnormal loss of Material and time.
10. Promoting corporate Governance by various operational disclosures to the directors.

→ Advantages of Cost Accounting Standards :

The advantages of Cost Accounting Standards are as follows :-

1. Provide a Structured Approach to measurement of Costs in Manufacturing process or in Service industry.

2. Provide Guidance to users to achieve uniformity and Consistency in classification, Measurement, assignment and allocation of Costs to products or Services.

3. Arrive at the basis of Computing the cost of Product, Activity, or Services where required by legally or by regulatory bodies.

4. Enabling Practicing Members to make use of Cost Accounting Standards in the attestation of General Purpose Cost Statements.

5. Assist in clear and uniform understanding of all the related issue of various user organizations, Government bodies, regulators, research agencies and Academic institutions.

Companies (Cost Records and Audit) Rules, 2014.

→ RULE 1 : Short title and Commencement :-

① These rules may be called the Companies (Cost Records and Audit) Rules, 2014.

② These rules shall Came into force on the date of Publication in the official Gazette i.e 30.06.2014.

→ RULE 2 : Definitions :-

① Cost Accountant in Practice means a Cost Accountant as define under CWA Act, 1959, who holds a valid certificate of Practice and includes a Firm or LLP of Cost Accountants.

② Cost Auditor means a Cost Accountant in practice, who is appointed by BOD.

③ Cost Audit Report means the duly Signed cost Auditor's Report on the Cost Records examined and cost Statement prepared including attachment, annexure, Qualifications or observations attached.

④ Cost Records means book of Accounts relating to utilisation of Materials, labour and other items of Cost as applicable to the Production of Goods or Provisions of Services.

→ Rule 3 : Application of Cost Records :-

1. Every domestic or foreign Company which are covered under Regulated Sector or Non-Regulated Sector require to Maintain Cost Records for their Products or their Services.

2. Regulated Sector covers those Products or Services under Table (A).

3. Non-Regulated Sector covers those Products or Services under Table (B).

4. The limit of Total Turnover for Preparation of Cost Records is ₹ 35 crore or more of Preceding Year, for Products or Services covered under Table (A) or Table (B) or both.

5. The Micro enterprise or Small enterprise as per MSMED Act, 2006 are exempt from Cost Records.

6. It is clarify that we have to See Total Turnover for ₹ 35 crore limit but Cost Records is Mandatory for Table (A) and Table (B) Products.

→ RULE 4 : Applicability for Cost Audit :-

① Regulated Sector such as Telecommunication, Electricity, Petroleum & Gas, Drugs & Pharma, fertilizers and Sugar & industrial alcohol, limits for Cost Audit are :-

Ⓐ Turnover from all type of products or Services Manufacturing or rendering should be ₹ 50 crore or more during Preceding Year.
and,

Ⓑ Turnover from Products Manufacturing or Services Rendering which covers under Table A (Regulated Sector) or under Table B (Un-Regulated Sector) or both should be ₹25 crore or more during Preceding year.

If both the above conditions are fullfilled by such Regulated Sector then Cost Audit shall be Applicable on the Cost Records of Products or Services covered under Table Ⓐ.

② For Remaining 33 un-Regulated Sector, limits for Cost Audit are as follows :-

Ⓐ Turnover from all types of Products or Services Manufacturing or rendering should be ₹ 100 crore or More during Preceding year.
and,

Ⓑ Turnover from Products Manufacturing or Service Rendering which covers under Table Ⓐ (Regulated Sector) or under Table Ⓑ (unRegulated Sector) or both should be ₹35 crore or more during Preceding Year.

If both the above conditions are fulfilled by such Non-Regulated Sector then the Cost Audit shall be applicable on the Cost Records of Products or Services covered under Table (B).

(3) If in case, Products or Services under Table (A) or/and Table (B) fulfills all the four above conditions then Cost Audit shall Apply on All Cost Records of Products or Services covered under Table (A) and (B).

CASES:	Turnover from Table (A) products or Services. (₹) (A)	Turnover from Table (B) Products or Services. (₹) (B)	Turnover from all other products or Services. (₹)(C)	Total T.O of Table (A) & (B) Products or Services (₹) A+B	Total T.O of All products/ Services (₹) A+B+C	Applicability of :- Cost Record	Cost Audit
(1)	6 crore	9 crore	13 crore	15 crore	28 crore	No	No
(2)	8 crore	8 crore	26 crore	16 crore	42 crore	Yes	No
(3)	18 crore	8 crore	26 crore	26 crore	52 crore	Yes	Yes on (A) Table (A)
(4)	18 crore	18 crore	28 crore	36 crore	64 crore	Yes	Yes on (A) Table (A)
(5)	20 crore	25 crore	65 crore	45 crore	110 crore	Yes	Yes on A & B both.
(6)	38 crore	0	65 crore	38 crore	103 crore	Yes	Yes on (A) Table (A)

(4) Exception of Applicability of Cost Audit :-

Cost Audit will be Exempted even if Turnover limit is crossed, if the Company falls in any of the following categories :-

(A) Company is operated from SEZ.

(B) If Revenue of Company from export (in foreign exchange) exceeds 75% of Total Revenue.

(C) Company engaged in generation of electricity for Captive Consumption.

→ RULE 5 : Maintenance of Cost Records :-
Cost Records in form no. CRA-1 shall be maintained on a Regular basis (i.e Monthly, Quarterly or Half-Yearly) or Annually) for the calculation of :-

A) Per unit Cost B) Cost of Sale c) Margin Per Product/Services.

→ RULE 6 : Cost Audit :-

(1) Any Casual Vacancy in the office of a Cost Auditor, whether due to resignation, death or Removal, to be filled by BOD within 30 days.

(2) And company shall inform to C.G in form CRA-2 within 30 days from Appointment of new cost Auditor.

→ Appointment of Cost Auditor :-

① Companies covered under the Provision of Cost Audit shall appoint a Cost Auditor within 180 days from the commencement of every F.Y.

② Cost Auditor shall give a written consent and a certificate to the Company after his appointment.

③ Such certificate contains following declaration :-

(A) The individual or firm or LLP is eligible for appointment under CWA Act, 1959 and Companies Act 2013.

(B) The Proposed appointment is within the limits laid down under CWA Act, 1959.

(C) The list of Proceedings against the Cost Auditor related to Professional Misconduct as disclosed in the certificate is True or not.

④ Company shall inform to C.G in form CRA-2 within 30 days from Such Appointment. about the Appointment of Cost Auditor.

⑤ Cost Auditor shall Submit cost Audit Report within 180 days Prior from closure of Such F.Y, to BOD in form no. CRA-3.

(6) BOD may Removed Such Cost Auditor after Passing Board Resolution at any time.

(7) Any Casual vacancy shall be filled by BOD within 30 days and inform to C.G about new cost Auditor (in CRA2) appointed from the date of Appointment, within another days.

(8) Every Company shall Submit Such Cost Report to C.G in form CRA-4 within 30 days of Receipient of Report from Cost Auditor.

(9) If a company once covered under the Provisions of Cost Records or cost Audit then criteria of Cost Records or of Cost Audit shall be Followed in Subsequent years even Turnover exceed Specified limit or not.

Annexures to the Cost Audit Report (i.e with CRA-3)

→ PART (A) for Both Manufacturing and Service Sector.

Para :-	Content :-
1	General information of company like Name, CIN, address etc.
2	General details of Cost Auditor.
3	Cost Accounting Policy on Material cost, depreciation etc.
4	Details of Product produced or Service rendered.

→ PART (B) for manufacturing Sector.

Para :-	Content :-
1	Quantitative details of Capacity.
2	Abriged Cost Statement.
2A	Details of Material consumed.
2B	Details of utility.
2C	Details of Industry Specific operating expenses.

PART (C) - For Service Sector :-

Para :-	Content :-
1	Quantity information for Each Service.
2	Abriged cost Statement for Each Service.
2A	Details of Material consumed for Services rendered.
2B	Details of utilities.
2C	Details of Industry Specific operation expenses.

PART (D) - For both Manufacturing and Service Sector.

Para :-	Content :-
1	Products and Services Profitability Statement.
2	Reconciliation Statement b/w Cost Reards and Financial Records.
3	Value addition and distribution of Earnings.
4	Financial Position and Ratio Analysis.
5	Related Party Transactions.
6	Reconciliation of Indirect Taxes.

Study Note 3 : Cost Audit Documentation and Audit Process.

→ Cost Audit documentation :- Cost Audit documentation means the material including working papers prepared by the cost Auditor and retained them by him during performance of the Audit.

→ Audit File :- Audit file means one or more folders or other storage media in physical or in electronic form, containing the records that comprise the Audit documentation for a specific assignment or Audit.

→ Audit working Papers :- Audit working Papers are the documents which record all audit evidence obtained during Audit.

Such documents are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the relevant Cost Audit and Assurance standards.

→ Audit stages :- The stages of an Audit of cost Statement are as follows :-

① Planning. ② Performing. ③ Reporting.

Planning an Audit - First stage :-

1. "It is well said that a well planned Audit is almost half way done."

2. The planning stage involves determination of Audit strategy as well as identifying the nature and the timing of the procedures to be performed.

3. This is done to optimize efficiency and effectiveness when conducting an Audit.

4. Efficiency refers to the amount of time spent in gathering audit evidence. Effectiveness refers to the minimisation of Audit Risk.

5. A well-planned Audit will ensure that sufficient appropriate evidence is gathered to Minimize Risk of Material Misstatement at the Cost Statement level.

Performing an Audit - Second Stage :-

1. The Performance or execution stage of the audit involves detailed testing of internal controls, material consumption, allocation, apportionment and absorbtion.

2. If an auditor plans to believe on their client's system of internal controls then they will conduct tests of controls.

3. Cost Auditor will conduct detailed Substantive tests of Audit Procedures for the period and detailed substantive tests of consumption and balances recorded at the Period end.

4. This detailed testing provides the evidence that the cost Auditor requires to determine whether the cost statements have been fairly presented.

Concluding and Reporting on an Audit - Final Stage:-

1. The final stage of the Audit involves drawing conclusions based on the evidence gathered and arriving at an opinion regarding the fair presentation of Cost Statements. The cost Auditor's opinion is expressed in the cost audit report.

2. At this stage of the audit, a cost auditor will draw on their understanding of the client, their detailed knowledge of the risks faced by the client, and the conclusions drawn when testing the entity's controls, transactions, cost heads, item of cost and related disclosures.

→ Practical steps of Audit Process :-

Step ① : Objectives of Audit and Management outlook :-

First step of Cost Audit is to achieve following objectives :-

① Cost optimization or cost reduction.

② checking parameters of operational efficiency of a unit.

③ Suggesting product diversification or changed product-Mix.

④ Identifying profit making or loss making products.

⑤ Suggesting changed Marketing strategies, Market expansion, Market diversification.

⑥ Complete review of business strategies.

Step ② : Pre- conditions :-

Followings things should be understand by cost Auditor:-

① objectives of Cost Audit.

② Area, nature and Scope of Audit.

③ Numbers of Cost auditors appointed.

④ The applicable Reporting Frame work.

⑤ The Reporting Period.

⑥ The Statutory deadlines.

Step ③ : Understanding the company's Business :-

① The cost auditor is required to understand the company's business, its corporate structure and various systems being followed and all General details.

② Internal control System and Internal Audit System followed by company.

③ Accounting and Cost Accounting systems and policies followed by company.

④ Previous Cost Auditor's Report should also be read by such Cost Auditor.

Step (4) : Planning the Audit :-

Planning of a Cost Audit includes :-

1. Timing (dates) and duration (no of days) of audit Period.
2. level and number of audit personnel to be deployed.
3. Audit Partner to be deployed (his expected days and dates).
4. Drawing up an overall audit plan and audit Strategy.
5. Document the Audit Plan and share it with the company.
6. Ensure all the Process should be Followed properly.

Step (5) : Execution of Audit :-

1. Perform the Audit checks and Procedures as per planned.
2. Collect all required audit evidence enabling the auditor to form his opinion.
3. Prepare draft observation and discuss with Key Management Personnel.
4. Prepare final Audit Report.

Step ⑤ : Audit documentations :-

① Document the Audit plan and Audit Strategy.

② Document all working Papers.

③ Document all the Audit evidences.

④ Document the drafted observations and discussions.

⑤ Document the Final Report.

⑥ Preserve all document in a bound Folder or in a file.

Study Note - 4 : Cost Auditor - Professional ethics and Responsibilities.

→ Code of ethics to be followed of a Cost Auditor :

As professionals in the fields of Cost and Management Accounting, the members of our institute are bound by a code of professional ethics.

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

Following are the such code of ethics :-

① Integrity :- A cost Accountant should be straightforward and honest in Performing his Services.

② objectivity :- A cost Accountant should be fair and should not allow prejudice or bias or influence of others, which overide their objectivity.

③ Competence :- A cost Accountant must Refrain from Performing any Service which he is not competent to carry out such service. All the Services must be performed after Proper advice and assistance is obtained to ensure that the Service is performed to the Satisfaction.

(4) Confidentially :- A cost Accountant must not disclose information acquired during the course of his engagement and should not use or disclose any such information without proper and specific authority.

(5) Profesional Behaviour :- A cost Accountant should act in a manner consistent with the good Reputation of the profession.

→ Section 143 of Companies Act, 2013 : Duty of a Cost Auditor to Report Fraud :-

(1) If the Cost Auditor has reasons to believe that an offence involving Fraud is being or has been committed against the company by its officers and employees then Cost Auditor shall immediately report such Fraud to the Central Goverment.

(2) Fraud Reporting to the Central Government shall only be made in case of Amount involving Rs 1 crore or more.

(3) If means cases having Amount less than Rs 1 crore have to Report to BOD or to Audit Committee within 2 days.

(4) After Reporting to BOD or to Audit committee, the Cost Auditor have to wait for a period of 45 days for a Reply from them.

(5) Otherwise Cost Auditor shall Report about such Fraud to the central Government.

(6) After receipient of Reply from BOD or from Audit committee, the cost Auditor examine such reply, forwarded it to central Government along with his comments, within 15 days.

(7) Fraud Reporting by Cost Auditor involves :-

(A) Nature of fraud with description.

(B) Approximate Amount involved.

(C) Parties involved.

(D) Remedial Actions Taken (in case fraud reporting to BOD).

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

(8) If a cost Auditor doesnot comply with the provisions of Fraud Reporting then Pay penalties as follow:-

(A) Rs 5 lakh in case of listed company.

(B) Rs 1 lakh in case of other companies.

→ Section 447 : Punishment For Fraud For cost Auditor :-

(A) Amount of Fraud is ₹10 lakh or 1% of Turnover of the company, whichever is lower, Punishments are :-

(1) Minimum Imprisonment is 6 Month.
(2) Maximum Imprisonment is 10 years.
(3) Minimum fine shall be 100% of Amount of Fraud.
(4) Maximum fine shall be thrice of Amount of Fraud.

(B) In other cases, Punishments are :-

(1) Maximum Imprisonment is 5 years.
(2) Maximum fine shall be ₹50 lakhs.

Fraud Means :-

(1) Ommission, concealment of any fact.

(2) Abuse of position.

(3) Intent to decieve Someone.

(4) Intent or do injured the interest of company, shareholders, creditors or of any other.

(5) Wrongful gain or loss for which the person is not legally entitled.

→ Section 448 : Punishment For False Statement :-
All the provisions of Punishment are imposable u/s 447.

Penal Provisions for Professional Misconduct :

(A) For Schedule I :-

1. Give warning to the member.
2. Remove the name of member for 3 month.
3. Fine upto ₹ 100,000.

(B) For Schedule II :-

1. Give warning to the member.
2. Remove permanently the name of the Member.
3. Fine upto ₹ 500,000.

(C) Section 24 of CWA Act, 1959, Penalty are as follows :-

1. On first offence, fine of upto ₹ 1000.
2. On Subsequent offence, fine of upto ₹ 5000 or imprison-ment upto 6 months or both.

And such offence are as follows :-

1. Act as a Member, but not a member of institute.
2. Use designation of Cost Accountant but not the Member of the institute.
3. Doing Practice as a cost Accountant but not have a valid COP.

(D) Section 25 of CWA Act, 1959, Penalty are as follows :-

(1) On first offence, fine upto ₹ 1000.
(2) On Subsequent offence, fine upto ₹ 5000 or Imprison-ment of upto 6 months or both.

And such offence are as follows :-

(1) Use a name or common Seal identical to the institute

(2) Award any degree, diploma or certificate of any qualification or competence in cost accountancy similar to that of a member of institute.

(3) Seek to regulate in any manner whatsoever the profession of Cost Accountants.

(E) Section 26 of CWA Act, 1959, Penalty are as follows :-

(1) On first offence, fine upto ₹ 1000.
(2) On Second offence, fine upto ₹ 5000.

Offence is, No company can do Practice as a Cost Accountant.

(F) Section 27 of CWA Act, 1959, Penalty are as follows :-

(1) On first offence, Min. fine ₹ 1000 or Max. fine ₹ 100,000.

(2) On Subsequent offence, Min. fine ₹ 10000 or Max. fine ₹ 200 000, imprisonment upto 1 year.

Offence is No person other than a Member of the Institute shall sign any legal documents on behalf of Practicing cost Accountant or firm of Practicing cost Accountant in his or its professional capacity.

CAS 1 : Classification of Cost

→ Abnormal Cost : Abnormal Cost is an unusual Cost whose occurence is usually irregular and unexpected due to some abnormal situations arises in the Production.

Abnormal cost includes such unavoidable cost which cannot be ignore even the Production not Takes Place.

It also Means those Annual expenses are Mandatory expenses not Related to Production but have to be Paid are known as Abnormal Cost.

Interruption in the Production may be due to strike, lockdown, Break down of Machinery, fire etc. and in this Interruption situation some Cost have to be Paid which is known as abnormal Cost.

Abnormal Cost such as :-

→ Indirect Expenses.
→ Depreciation.
→ fixed expenses not related to Production.
→ Variable cost Payable due to Interruption.
→ Fixed cost Payable due to Interruption.
→ And any other Proportionate Cost Payable during interruption.

→ Administrative Overheads : Cost of all activities relating to general Management and administration of an entity.

Administrative overheads shall exclude Production o/H, Marketing overheads, Interest & Finance charges.

→ Conversion Cost : Conversion Cost is the Production cost excluding the Cost of Direct Materials.

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

Such unit can be a division, a department, a Section, a Group of Plant and Machinery, a Group of employees or any other combination of Several unit.

→ Cost object : An activity, contract, cost centre, customer, Process, Product, Project, Services or any other object for which costs are ascertained.

→ Cost of Production : Cost of Production of a Product or a Service consist of following items :-

Cost of Material Consumed.
Direct employee Cost.
Direct Expenses.
Production overhead.
Quality control cost.
Packing Cost.
Research and development Cost
Administrative overhead relating to Production.

Further adjustment for stock of WIP, finished Goods, Recoveries for Sales of Scrap, wastage shall be made.

→ Cost unit : Cost unit is a form of Measurement of volume of Production of a Product / Service.

Such as Power → MW (Mega watt)
Cement → MT (Metric Tonne)

→ Basis of classification of Cost :

① By Nature of Expense :-
→ Material.
→ Employee.
→ Other Expenses. (Direct)

② By Nature of Traceability to a Cost object :-
→ Direct Expenses.
→ Indirect Expenses.

③ By Functions | Activities :-
→ Production.
→ Administration.
→ Selling.
→ Distribution.
→ Research & development.

④ By Behaviour :-
→ Fixed.
→ Variable.
→ Semi-Variable.

⑤ By Nature of Production Process :-

- Batch Cost.
- Process Cost.
- Operating Cost.
- Contract Cost.
- Joint Cost.

→ Presentation and Disclosure under CAS-1 :-

① classification of Cost should be done on the basis of Relevant classification.

② classification of Cost item should be Followed consistently from Period to Period.

③ A change in classification of cost should be made only if it is Required by law or for compliance with CAS.

④ Any change in classification of cost which has a Material effect on the cost of the Product should be disclosed in the cost statements.

CAS 2 : Capacity Determination :-

CAS 2 deals with the Principles and Methods of classification and determination of capacity of an entity for ascertainment of the Cost of Product or of Service.

→ Needs for Capacity Determination :-

① To identify capacities of each deployed facilities and identifying bottlenecks.

② To Evaluate Potential for future expansion, understanding the Scope and effort towards de-bottlenecking and balancing of Surplus capacities.

③ Internal Management for Planning, scheduling of Production and Monitoring during implementation of the Planned Programme.

→ Reporting of Capacity in form CRA-3 (Cost Audit Report) :-

Ⓐ Under Part Ⓑ of CRA-3 for Manufacturing Sector :-

① Installed Capacity.
② Capacity enhanced during the year, if any.
③ Capacity available through leasing arrangement, if any.
④ Capacity available through loan licensed / third Party.
⑤ Total Capacity in aggregate.

(B) Under Part (C) of CRA-3 for Service Sector :-

1. Installed Capacity.
2. Capacity enhanced during the year, if any.
3. Total capacity in aggregate.

→ Installed Capacity : It is the Maximum capacity of Producing Goods or Providing Services, determined either based on Technical specification of the facility or through a Technical evaluation.

→ Normal Capacity : It is the Production Amount achieved or achievable on an average over a Period or Season under normal circumstances after Taking into Account the loss of capacity resulting from planned Maintenance.

Normal capacity is also known as Practical or achievable capacity.

→ Determination of Installed Capacity : Installed capacity is the Maximum Productive capacity of a plant taking into Account the Following 5 factors :-

1. Manufacturer's Technical Specifications or Estimates by Experts.
2. Capacities of Individual or interrelated Production centres.
3. Operational constraints / capacity of critical Machine.
4. Number of shifts.
5. Technical Evaluation.

→ Determination of Normal Capacity :- Normal Capacity should be determined after adjustment of the following with the Installed capacity :-

① Holidays, Normal shut down days and Normal idle time.
② Normal time loss in batch change over, preventive maintenance, normal break downs of machines, repairs etc.

→ Determination of Idle Capacities and utilisation Ratios :-

① Idle Capacity = Installed Capacity − Actual capacity.

② Normal idle Capacity = Installed Capacity − Practical capacity.

③ Abnormal idle Capacity = Practical capacity − (Higher of Normal or Actual capacity)

④ Actual capacity utilisation = $\frac{\text{Actual Capacity}}{\text{Installed capacity}} \times 100$

⑤ Idle capacity utilisation = $\frac{\text{Idle capacity}}{\text{Installed Capacity}} \times 100$

⑥ Normal idle Capacity utilisation = $\frac{\text{Normal idle Capacity}}{\text{Installed Capacity}} \times 100$

⑦ Abnormal idle Capacity utilisation = $\frac{\text{Abnormal Idle Capacity}}{\text{Installed Capacity}} \times 100$.

where,

→ Installed Capacity = Maximum Productive Capacity of a Plant.

→ Practical Capacity = Reduction in Install capacity due to unavoidable Reason / Factor of Internal causes.

→ Normal Capacity = Reduction in Practical capacity due to unavoidable Reason / Factor of external causes.

→ Actual Capacity = Reduction in Normal capacity due to any other Factors / Reasons.

→ Determination of idle Capacities under Revised CAS-2 :-

① Idle Capacity = Installed capacity - Actual capacity.

② Normal Idle Capacity = Installed capacity - Normal capacity.

③ Abnormal Idle Capacity = Normal capacity - Actual capacity.

where,

→ Installed Capacity = Maximum Productive Capacity of a Plant.

→ Normal Capacity = Reduction in Installed capacity due to normal Reason / Factors internally.

→ Actual Capacity = Reduction in Normal Capacity due to abnormal or other Reason / Factors.

→ Disclosures to be required under CAS-2 :-

1. Basis of calculating Capacity.
2. Any changes in Installed and Normal capacity from Period to Period with reasons.
3. Capacity enhanced through outsourcing should be disclosed.
4. Capacity in terms of Self-Production.
5. Reasons for low capacity utilization.
6. Abnormal Cost due to under utilization of Capacity.

CAS 3 : On Production and operation overheads.

CAS 3 deals with the Principles and Methods of classification, Measurement and assignment of Production and operation overheads.

→ Definition of Overheads : Overheads comprise of Indirect Materials, Indirect employees, and Indirect expenses which are not directly identifiable or not directly allocate to a Cost object.

classification of overhead are as under :-

→ Production overhead.
→ Administrative overhead.
→ Selling overhead.
→ Distribution overhead.
→ Fixed, Variable and Semi Variable overhead.

Exclusion from overhead are as under :-

→ Overheads incurred due to some abnormal situations because its charged to Costing Profit & loss Account.

→ Overheads not related to business Activities like donations, loss on Sale of asset.

→ Borrowing Cost and other financial charges.

→ Foreign exchange Fluctuation losses.

→ Measurement Principals for Overheads :-

① Any abnormal Cost where it is Material and Quantifiable shall not form Part of the Production or operations O/H.

② Any Imputed cost (non cash expenses or Notional Cost) shall not form Part of the Production or operations O/H. except depreciation.

③ Any overhead variances due to abnormal reasons shall not form Part of the Production or operations O/H. But variances due to normal reasons shall be considered.

④ Any Subsidy, Grant, Incentive or any similar amount received or receivable with respect to Production or operations overhead shall be Reduced from Cost.

⑤ Any fines, Penalties, damages or any levy Paid or Payable to statutory authorities or to other third Parties shall not form Part of the Production or operation overhead.

⑥ Any credits or Recoveries relating to Production or operation overheads shall be deducted from the Cost.

⑦ Any change in the Cost Accounting Policies related to Production or operation overhead shall be made if required by law for compliance with CAS.

→ Absorbtion of Production or operations overheads :-

① The Variable Production or operations overheads shall be absorbed to Products or Services based on Actual Production.

② The fixed Production or operations overheads shall be absorbed based on the Normal capacity.

→ Presentation under CAS 3 :-

① Production or operation Overheads shall be presented as Separate Cost head.

② If material & necessary, element wise and behaviour wise details of the production or operation O/H shall be presented.

③ Any under or over absorbtion of Production or operation overhead shall be presented in the Reconciliation statement.

→ Disclosures under CAS 3 :-

1. The basis of assignment of Production or operation overhead to the cost object.

2. Production or operation overhead incurred in foreign exchange.

3. Production or operation overhead incurred relating to resources received from or Supplied to related parties.

4. Any Subsidy, Grant, Incentive etc. received or receivable which get Reduced from Production or operations O/H.

5. Credit or recoveries relating to Production or operation O/H.

6. Any abnormal cost not forming Part of Production or operation overhead.

7. Any underabsorbed Production or operation overheads.

CAS 4 : Cost of Production / Acquisition / Supply of Goods or Provision of Services.

CAS 4 deals with the determination of Cost of Production or Acquisition or supply of Goods or Provision of Services.

This standard deals with the Principles and Methods of classification, Measurement and assignment for the determination of Cost of Production or Acquisition or Supply of Goods or provision of Services as Required under the Provisions of GST Act, 2017.

As per CGST Act, 2017 Value of Supply of Goods or Services are determined as follows :-

→ Rule 27, where the Supply of Goods or Services is for a consideration which is not wholly in Money then the value of Supply shall be open Market Value.

→ Rule 28, Value of the Supply of Goods or Services b/w distinct or related Persons (except agent),
then the Value of Supply shall be open Market Value.
but if the Receipient wants to do further Supply then the Value of Supply shall be 90% of Price charged from its customer.

→ Rule 29, Value of the Supply of Goods or Services b/w Principal and agent,
then the value of Supply shall be open Market Value.
but if the agent wants to do further Supply then the Value of Supply shall be 90% of Price charged from its customer.

→ Rule 30, the Value of Supply shall be 110% of the Cost of Production or of the Cost of Acquisition of Such Goods or the Cost of Provision of Such Services.

→ Scope of CAS 4 are as follows :-

1. Determination of Cost of Production of Goods.
2. Determination of Cost of Acquisition of Goods.
3. Determination of Cost of Supply of Goods.
4. Determination of Cost of Supply of Services.

5. Determination of value of Supply of Goods or Services as per open Market.

→ Cost of Production of Goods consist following elements :-
- → Material Consumed.
- → Direct wages and Salaries.
- → Direct Expenses.
- → Works overheads.
- → Quality control Costs.
- → Research and development cost.
- → Packing Costs.
- → Administrative overheads related to Production.

→ Cost of Purchase / Acquisition of Goods consist following elements :-
- → Purchase Price.
- → Import duties and other Taxes (net of Trade discounts, Rebate, Taxes and duties).
- → Transport, handling charges.
- → other costs directly attributable to the acquisition of Goods and Services.

→ Cost of Provision of Service consist following elements :-

- → Cost of Materials consumed.
- → Direct Employee Costs.
- → Direct Expenses.
- → Quality control costs.
- → Research and development Costs.
- → Operation Overheads and administrative overheads relating to provision of Services.

→ Principles of Measurement of Cost under CAS 4 :-

1. Cost of Production or Acquisition of Goods or Provision of Service shall be measured for Each types of Goods or Services Separately.

2. Cost of Normal scrap | defectives shall be included.

3. Realized or Realizable value of Scrap or of waste shall be deducted or its Reprocessing cost if Reprocess it.

4. Cost of abnormal scrap | waste not be considered, because it charged to Costing Profit & loss Account.

5. Cost of Packing shall be included.

6. High value spare shall be recognised as PPE and depreciated accordingly.

7. Depreciation of an Asset begins when it is available for use.

(8) One time Payment for Royalty or Technical know how shall be Amortised on the basis of estimated output or benefit.

(9) Royalty Paid for use of Asset or for Transfer of Technolo-gy shall be included But Royalty Paid for use of Brand shall not be included.

(10) In-house Quality Cost incurred shall be Included. And the Cost of Resources Procured from outside shall be determined at invoice value or at agreed price.

(11) Production or Operation overheads representing Procurement of Resources shall be determined at Invoice value or at agreed Price.

(12) Any abnormal Cost, where it is Material and Quantifiable shall not be considered and charged to Costing Profit & Loss Account.

(13) Interest and finance costs shall not be considered.

(14) Any Impairment loss or Imputed cost shall not be considered.

(15) Any Inputs Received from Receipient of Goods or Services as free or at concessional rate shall be considered.

(16) Cost of any free Tools, Pattern, dies, drawings, blue prints, Technical Maps, charts, design etc shall be amortised.

(17) Cost of Rework, Reconditioning, Adjustment for WIP, Recoveries from Sale of Scrap & wastages shall be considered.

(18) Any Subsidy, Grant or incentive received or receivable shall be deducted.

(19) Fines, Penalties, damages, demmurages charges etc Paid to Statutory Authorities shall not be included.

(20) Any loss due to Foreign exchange Rate difference shall not be considered.

(21) Any credits or Recovery received shall be deducted.

(22) opening and closing WIP shall also be adjusted.

→ Assignment of Cost under CAS 4 :-

(1) Any abnormal and Non-Recurring costs, abnormally low plant utilisation, abnormal Rejections, accidents, strikes, fires, unexpected court orders etc. shall be ignored.

(2) The Cost which can be traced directly to each type of Goods or Services shall be directly assigned, and which are not Traceable then assigned on following basis:-

A) Cause and effect : Cause is the Process or operation or Activity.
Effect is the incurrence of Cost.

B) On the basis of Benefit Received.

③ The variable produ/operation overheads shall be absorbed based on Actual production.

④ The fixed or operation or production overhead shall be absorbed on the basis of Normal capacity or Actual capacity whichever is higher.

⑤ In case Joint Products are Produced, Joint Cost incurred upto the split off point are proportionately apportioned on the desire basis of company.

⑥ In case By-Products are Produced, the NRV of by products is credited (Reduced) to the Manufacturing cost of Main Product.

⑦ Any Miscellaneous Income relating to Production or operations shall be adjusted. Such as Sale of Empty containers.

→ Presentation under CAS 4 :- Cost statement should be prepared as per the applicable format Given in the Appendix to this standard and Such Appendix are as follows :-

Appendix 1 : Statement of Cost of Production of the Taxable Goods.
Appendix 2 : Statement of Cost of Provision | Supply of the Taxable Services.
Appendix 3 : Statement of Cost of Acquisition of Taxable Goods.
Appendix 4 : Statement of open Market Value.

These Cost Statements are certified by the Cost Accountant in Practice, which enable the business entity to determine value of Taxable Goods or Services at that time of Supply and issuance of Tax Invoice.

Such certified Cost statements shall be Presented with the following Periodicity :-

→ On Six Month basis, if Turnover in the Preceding year of a Composition dealer under GST did not exceeds limit of composition scheme.

→ On Quartely basis, if Turnover in the Preceding year of a composition dealer under GST exceeds limit of Composition scheme.

→ On Annual basis, if GST Audit is Required i.e on or before 31 december of Next F.Y.

Disclosures under CAS 4 are as follows :-

(1) Disclosure shall be made only where it is necessary, Significant and Quantifiable.

(2) If there is any change in Cost Accounting Policies, Principles and Practice, Same Shall be disclosed.

(3) If opening WIP and closing WIP are not ready for certification, Same shall be disclosed.

(4) Any other disclosure as may be deem fit by a Practicing Cost Accountant during Cost Audit.

Study Note - 6 Overview of Cost Auditing standards.

INTRODUCTION :-

① The Companies (Cost Records and Audit) Rules 2014 were notified by the Ministry of corporate Affairs, Government of India in exercise of the Powers u/s 148 of companies Act, 2013.

② Subsection (3) of Section 148 prescribes that the Auditor shall follow the Cost Auditing standards during Performing the Cost Audit.

③ Cost Auditing standards are issued by the "Institute of Cost Accountants of India" under the Cost and works Accountants Act, 1959 with the approval of central Government.

④ Following are the Cost Auditing standards :-

Ⓐ Cost Auditing standard - 101 on Planning an Audit of Cost statement.

Ⓑ Cost Auditing standard - 102 on Cost Audit Documentation.

Ⓒ Cost Auditing standard - 103 on Overall objectives of the independent Cost Auditor.

Ⓓ Cost Auditing standard - 104 on knowledge of business, its processes and the business.

Cost Auditing standard-101 on Planning an Audit of Cost statements :-

(1) Planning an Audit of cost statements, Records and other related documents is considered necessary to ensure achievement of Audit objectives with availa-ble resources and securing coordination with the Auditee on Audit work.

(2) This standard is effective for Audits on or after September 11, 2015.

(3) This standard deals with auditor's Responsibility to plan an audit of cost staments, Records and other related documents.

(4) Prior to entering the planning phase, the Cost Auditor shall ensure that :-

(A) the appointment as Cost Auditor is proper, he has received the letter of appointment and legal form-alities regarding his appointment have been fulfilled;

(B) the ethical requirements as per the regulations continue to be satisfied

(C) an understanding of the terms of reference including the units to be covered, products or services to be covered and scope of coverage.

(5) The Audit Partner and other Key Members of an Audit team shall be involved in Planning the Audit.

(6) The Cost Auditor shall formulate an overall Audit strategy that sets the scope, timing and direction of the Audit.

(7) Followings are the relevant Factors required for Overall Audit strategy :-

(A) Results of Preliminary Activities.

(B) Knowledge from Previous Audits and other engagements with the Auditee.

(C) Knowledge of business.

(D) Nature and Scope of the Audit.

(E) Statutory deadlines and Reporting format.

(F) Nature, timing and extent of Resources required for the Audit.

Cost Auditing standard-102 on Cost Audit Documentation:

① The Purpose of this standard is to provide guidance to the members in preparation of Audit Document-ation in the context of the Audit of Cost statements, Records and other related documents.

② Nature and Purpose of Cost Audit documentation are as follows :-

Ⓐ Evidence of the Cost Auditor's basis for a conclusion about the achievement of the overall objectives of the Cost Auditor

Ⓑ Evidence that the Cost Audit was planned and Performed in accordance with Cost Auditing standards and applicable legal and Regulatory requirements.

Ⓒ Assisting the Audit team to plan and perform the Cost Audit.

Ⓓ Assisting members of the Audit team responsible for supervision to direct and supervise the Cost Audit work, and to discharge their review responsibilities.

Ⓔ Enabling the Audit team to be Accountable for its work.

(3) Objectives of Cost Audit documentation are as follows :-

(A) A sufficient and appropriate record on the basis of Cost Audit Report shall be maintain.

(B) Provide / Faciliate Evidences, that the Audit was planned and performed in accordance with Cost Auditing standards and all applicable legal and Regulatory requirements.

(4) The Cost Auditor shall record all the discussions with client personnel and with outsiders.

(5) The Cost Auditor shall record all the Audit evidence, Results of Audit performed.

(6) The Cost Auditor shall record Nature, timing, Scope of Audit performed.

(7) The Cost Auditor shall maintain all the new or additional Audit procedure after the date of Cost Audit Report.

(8) The Cost Auditor shall prepare Audit documentation on a timely basis.

(9) The Cost Auditor shall assemble the Audit documentation in an Audit file.

(10) Cost Auditing standard 102 is also effective for Audits on or after September 11, 2015.

Cost Auditing standard overall objectives of the independent Cost Auditor and the conduct of an Audit in accordance with Cost Auditing standards - 103:-

① This standard deals with the overall objectives of the Independent Cost Auditor, the nature and scope of a Cost Audit.

② Cost Auditing standard - 103 explain the requirements establishing the General Responsibilities of the Independent Auditor.

③ Objectives of Cost Auditing standards - 103 are as follows :-

Ⓐ To obtain reasonable assurance about whether the Cost statements are free from Material Misstatement.

Ⓑ To express an opinion on whether the Cost statements represent a true and fair view of the cost of production, Cost of Sales and Margin of Products covered by the Cost Audit.

Ⓒ Where reasonable assurance cannot be obtained then the Cost Auditor should Qualify the opinion.

Ⓓ The Cost Auditors objective may extend to making observations and suggestions where required by applicable regulations.

(4) The Cost Auditor shall comply with the all relevant ethical requirements in respect of Cost Audit engage-ments.

(5) The Cost Auditor shall comply with each of the relevant Cost Auditing standard applicable in a Proper manner.

(6) The Cost Auditor shall plan and Perform an Audit with an attitude of professional Suspicion.

(7) The Cost Auditor shall obtain sufficient appropriate Audit evidence to reduce Audit Risk.

(8) The Cost Auditor shall determine whether the Cost Reporting Framework followed by Management in Preparing Cost statements is in line with the Companies Act, 2013.

(9) This standard is effective for Audits on or after September 11, 2015.

Cost Auditing standard -104 on Knowledge of business, its processes and the business environment :-

① The Cost Auditor should have the Knowledge of the client's business to enable him to understand the processes and express his opinion on the Cost statements.

② The Cost Auditor's level of Knowledge for a Cost Audit engagement should include a General Knowledge of the economy and the Industry within which the entity operates, and a more particular Knowledges of how the entity operates.

③ The Cost Auditor should obtain an understanding of the following things :-

Ⓐ The nature of the entity (including its operations covering Business Processes, Major inputs, Joint and By products, Wastages, Major outputs etc.)

Ⓑ The entity's ownership and Governance structure.

Ⓒ Relevant industry, Regulatory, and other external factors including the applicable cost and Financial Reporting Framework.

Ⓓ The entity's selection and application of Cost Accounting Policies.

(4) Following are the understanding related to entity's Internal control :-

(A) Control Environment : The Cost Auditor shall Evaluate whether Management has created and Maintained a culture of honesty and ethical behaviour.

(B) Entity's Risk Assessment Process : The Cost Auditor shall obtain an understanding of whether the entity has a Process for :-

→ Identifying business Risks relevant to Cost reporting objectives.

→ Assessing the likelihood of their occurence.

→ Estimating the significance of the Risks.

→ Deciding about actions to address those Risks.

(C) Cost Information System | Management Information System : The Cost Auditor shall obtain an understanding of the Information System including MIS.

(D) Control Activities : The Cost Auditor shall obtain an understanding of the control Activities, relevant to Audit.

(E) Monitoring of Controls : The Auditor shall obtain an understanding of the major activities, that the entity uses to monitor internal control over Reporting.

(5) Following are the understanding related to IT (Information Technology) environment and control:

(A) IT Architecture, Systems and Programmes in use in the entity.

(B) Controls on Access to data.

(C) Controls on changes to data in Master files, Systems or programmes.

(D) Integrity of information and Security of the data.

(6) The Cost Auditor shall identify and Assess the Risks of Material Misstatement at the Cost statement level.

(7) This standard is effective for Audits on or after September 11, 2015.

Study Note - 7 Filing of Cost Audit Report to MCA in XBRL Format.

INTRODUCTION :-

1. XBRL stands for "Extensible Business Reporting language".

2. XBRL is the open international standard for digital business reporting, Managed by a Global not for Profit Purpose called XBRL International.

3. Millions of XBRL documents are created every year.

4. The change from Paper, PDF and HTML based Reports to XBRL is like the change from film photography to digital photography or from Paper Maps to digital Maps.

5. Every Company covered under the Cost Records and Audit Rules, shall within 30 days from the date of receipt of Cost Audit Report from the Cost Auditor furnish the Same Cost Audit Report along with all explanation on the Cost Auditor's opinions, to the central Government in FORM CRA-4.

6. FORM CRA-4 File online to the MCA Portal along with fees in XBRL Format.

→ Potential Uses of XBRL :- XBRL has applications in the following areas :

① Reporting for internal and external Purposes by an entity involving finance and Cost data / information.

② Business Reporting to all types of Regulators including Tax Authorities, central Banks and Governments.

③ Filing of Loan Reports and its applications.

④ Exchange of information between Government Departments.

→ Benefit From using XBRL :-

① XBRL has a Bright future ahead of it, all types of organisation can make use of XBRL to automate their Process of data collection and distribution to various stakeholders.

② It helps in Saving costs and improving the efficiency in Managing business information.

③ XBRL being extensible and Flexible which can be adapted to a wide variety of Requirements.

④ All stakeholders whether they are Preparers, Transmitt-ers or users of business data in the financial information supply chain can benefit from the use of XBRL to all of them.

→ Benefit of having Cost Related data in XBRL Format:

① Government and Regulators require Cost data of different sectors for Policy Making.

② The Availability of Cost data in XBRL format enables informed decision Making and for Sectoral studies.

③ with full adoption of XBRL, companies would be able to integrate its financial and Cost Data across its operational areas and exercise better control on its Activities.

→ Costing Taxonomy:

① Costing Taxonomy is a dictionary of all cost elements required in the cost Audit Report and compliance Report.

② The Costing Taxonomy contains the properties and interrelationships of all these cost elements for the Purposes of capturing the required Reporting in XBRL format.

→ How can the Cost Audit Report and compliance Report is converted into XBRL format :-

XBRL is an open source technology. Any of the following methods can be adopted to create the documents which required for filing of the Respective Reports :-

① XBRL enabled Software Packages developed by different software vendors which support the creation of Cost Reports in XBRL format and which can be used to create the necessary document.

② Various elements of Cost Audit Report and compliance Reporting can be design into XBRL Tags of the Costing Taxonomy.

③ Different third Party Packages can be integrated into the existing Accounting systems to Generate XBRL Cost statements.

④ There are various web based applications available that Take input reports in Various formats like MS Excel, Word, PDF etc and transform them into XBRL format.

→ What Process is to be Followed to file the Reports in XBRL Format :

1. Mapping the Individual Cost elements of the company to the elements of the Costing Taxonomy.

2. Populating the relevant data in the filing tool i.e Software.

3. Creating Instance documents.

4. Validating the Instance document with the validation Tool of MCA.

5. Use available Tool to convert the Instance document to a human Readable Format and check correctness of Data.

6. Attaching the Instance Document to the e-Form and filing on MCA Portal.

Study Note 9 : Basics of Management Audit

→ Definition of Management Audit :

Management Audit is the Process of Judging or Analysing the Performance of Directors, Managers. In other words, Analysing the Performance of the Management. It attempts to look into all Aspects of the Management Performance.

→ How is Management different from Administration :-

Administration is Concerned with the Structure of the organisation and the Mechanism of its operation, where as,

Management Relates to the leadership and direction of the People, the way in which they are controlled to Exercise their functions within the Administration frame work.

→ Agency Theory of Management :

① It is a relationship b/w two Parties in which one is Agent and another one is Principal in a day-to-day Transaction.

② The Principal have hired the agent to Perform a Specific Services on their behalf.

③ Most Commonly, that relationship is the one b/w shareholders & Stakeholders as Principal and b/w Company Executives as an agent.

④ Management Audit extends to Examination of Accountability b/w Management and others at large.

⑤ The Examination of Accountability and ensuring shareholder's welfare and other's executives welfare becomes Important.

→ Objectives and uses of Management Audit :

1. Assessment the Management Performance at all level of Management.

2. Highlight the decisions or Activities that are not in the favour with organizational objectives.

3. Ascertain such objectives are properly understood at the level.

4. Evaluate Plans which are Projected to Meet objectives.

5. Reviewing the Company's organizational Structure.

6. To Ensure optimum utilization of all the Resource Employed.

7. To Suggest Improvement in Methods of operation.

8. To Anticipate Problems and Suggest Remedies to Solve them in time.

→ Needs and Benefits for Management Audit :

① It helps Management in framing basics Policies for the organisation and to define objectives.

② It helps in Setting up an organisational framework to implement the plans.

③ It Assist in designing Systems and Procedures for Smooth operations of the organisation.

④ It helps in designing and Reviewing Management information System (MIS) for decision Making to help in Coordination, Motivation, and control of the operations.

⑤ It Assist in Analyzing SWOT (Strength, Weakness, opportunities, threats) of the organisation and Assist in Marketing the organisation More Stronger.

⑥ It can help in Analyzing Social-Cost benefit for Public Projects like Dams, Power houses, National highway etc.

→ Scope of Management Audit : Management Audit is wider in Scope and covers every Activity of the organisation.

Scope of Management Audit are as follows :-

1. Efficient utilisation of Resources of the organisation.

2. The Rate of Return of Investor's Capital, whether it is Poor, adequate or above average.

3. Relationship of the business with its own shareholders and with Investing General Public.

4. Suitablity of the Plans, Activities and decisions of the organisation with its desired objectives and Aims.

5. Reviewing Current image of the organisation among customers, General Public.

6. Ensuring Aims and effectiveness of Management as its various level such as Top level, Middle level, low level.

→ Qualities of Management Auditor are :

1. Ability to understand business Problems.
2. Ability to understand Purpose, objectives, Motive of an organisation.
3. Ability to Assist the Programme of Management.
4. Have to knowledge about the Principles of delegation of Authority.
5. Ability to understand different internal control devices, Flow charts, Flow of work, etc.
6. General understanding of all economic and commercial legislations, like company law, custom law, Tax laws etc.
7. Ability to prepare Reports for various level of Management.

→ Functions of Management Auditor :

1. Marketing including Selling and Distribution.
2. Manufacturing or Servicing including Maintenance of Supply chain, Maintenance of Machinery & equipments, etc.
3. Human Resource Management from Selection to Recruitment then Training, Motivating, Retaining etc.
4. Finance including Maintenance of Accounts and Providing Accounting information to Guide the Management about its Performance and Position.
5. Research and development including Application of Basic Research.
6. Maintaining Personnel Policies and Industrial Relations.

→ Sources of information to the Management Auditor:

① Management Survey : This is the best way to identify Possible controlable weakness.

② Management Reports : The Auditor's Review of Managem-ent and internal Reports may be used to obtain information on Progress, Status or Accomplishment of work.

③ Internal Audit or Inspection Reports : Just like Management Reports, Internal Audit or Inspection Reports can also be a valuable Source of Information on Problem areas.

④ Physical Inspection : Physical inspection of the organisation Activities and Resources by the Auditor can be a useful way of identifying Possible inefficiencies.

⑤ Discussion with the officials and employees : The Management Auditor can obtain valuable infor--mation on Problems areas through discussions with Responsible officials in the organisation and with other employee.

⑥ Testing Procedures and Practices : Test checking of the Practices and Procedures, may indicate Problem areas on weaknesses.

And, Thereafter documents, Reports of all the above Source discussed shall become "EVIDENCE of MANAGEMENT AUDIT" Performed.

→ Techniques of Management Audit :

① Accounting or Economic Techniques : It includes :-

(A) Break Even Analysis.
(B) Budgetary Control.
(C) Cost Management Techniques.
(D) Discounted Cash Flow and Net Present Value Method.
(E) Standard Costing and Marginal Costing.
(F) ABC Analysis.

② Scientific Techniques : It includes :-

(A) Using Computer Models to Take decision or to decide Material Mix / Product Mix.

(B) Network Analysis.
(C) Linear Programing.

③ Stastical Techniques : It includes :-

(A) Activity Sampling.
(B) Simulation Technique.
(C) Inter Firm Comparison.

(4) Personnel Techniques : It includes :-

(A) Attitude.
(B) Man-Machine Relationships.
(C) Training Methods.
(D) Profitability and Productivity Measurements.

(5) General Techniques : It includes :-

(A) Transfer Pricing.
(B) Corporate planning.
(C) Brain Storming.
(D) Information theory.

→ Characteristic of a Good Management Audit Report :

① Relevance : The Auditor's Report should be relevant to the area for which the Audit has been conducted.

② Comprehensive : The Audit Report should cover all the Aspects of the Audited areas.

③ Brevity : The Audit Report should be brief for explanation and for understanding.

④ Timelines : The Audit Report should be issued in a Timely Manner, So that Suitable Rectific-ation may be Taken on Time.

⑤ Motivating : The Management Auditor should use Positive wordings in the Audit Report.

⑥ Formatting & Presentation: The Audit Report Must be drafted in a Good format for the Reader.

→ Management Audit Programme (MAP) :

Management Audit Programme is an essential facility for conducting Management Audit.

It is a plan of Action drawn in advance for Taking up the Audit and to help the Auditor to cover the entire area of his functions.

Following are the contents of MAP :-

1. Review of the organizational objectives and Plan.
2. Study the Management Policies and Practices.
3. A critical review of the organizational Structure.
4. Study of the Systems and Procedures.
5. Evaluation of operations.
6. Study of the efficiency of use of Physical Resources Available.
7. Exercise of Proper Management control.
8. Regularly checking on Adherence to the all Statutory obligation Applicable.

Difference b/w Management Audit, Internal Audit, Financial / Cost Audit :-

Bases.	Management Audit	Internal Audit	Financial / Cost Audit.
Attitude	Friendly and Guider	Policeman or Judge	Watch dog.
Agency	Outside Team	Internal or external	Specially design-ated Person.
Force	Voluntary	Statutary in Some cases.	Statutary or voluntary.
Areas	Complete Managem-ent	Main Parts	Specific objective
Period covered	Past, Present and future.	Past and Present	Mainly Past.

PART (B) INTERNAL AUDIT :-

Internal Audit is an Independent Appraisal Activity within an organization for the Review of operation as a Service to Management.

It improves Managerial control by Measuring and Evaluating the effectiveness of other controls and by Maintaining a vigilant watch over the Risks.

→ Necessity of Internal Audit : The Necessity of Internal Audit are as follows :-

(1) Internal Audit assist Management to improve internal controls by identifying weaknesses in Systems and Provides an opportunity to correct those weaknesses.

(2) It helps to detect errors and frauds and Provides Suggestions to improve them which help the Management to take corrective Actions.

(3) It detects the Misuse of Resources in time which helps to Reduce unnecessary Expenses.

(4) It Increases the Morale of honest staff because evaluation of Performance of any staffs will be made at any time.

(5) Internal Audit checks the Books of Accounts, detections of errors and frauds and help in its correction.

(6) It helps capacity building for organizational effectiveness.

→ Internal Auditing under Companies Act, 2013 :-

List of compulsary Requirements for appointment of Internal Auditor in listed and specified Companies :-

1. Every listed company;

2. Every unlisted Public company having Paid up capital of ₹50 crore or more during Preceding F.Y;

3. Every unlisted Public / Private company having Turnover of ₹200 crore or more during Preceding F.Y;

4. Every unlisted Public / Private company having outstanding loans or borrowings from banks or Public financial Institutions Exceeding ₹100 crore or more at any Point of time during the Preceding F.Y;

5. Every unlisted Public company which has Accepted deposits of ₹25 crore or More at any Point of time during the Preceding F.Y.

If an existing Company fullfills any of the above condition than such company shall appoint an Internal Auditor within 6 months.

Eligibility for appointment as Internal Auditor : The Internal Auditor shall either be a Cost Accountant or a chartered Accountant or Such other Professional as may be decided by the Board of Directors.

Requirements for filing of form MGT-14 with the RoC on appointment of the Internal Auditor : The company is Required to file form MGT-14 with the RoC within 30 days from the date of Passing of Board Resolution because appointment of Internal Auditor Takes place after passing Board Resolution or upon the decision of Audit committee.

Important Note :- Statutory Auditor cannot be an Internal Auditor of the Same company.

Punishment for Contravention of any Provisions :-

1. The company and every officer of the company who is in default shall be Punishable with a fine upto ₹ 1000

2. In case of Subsequent offence, there shall be additional fine of ₹ 1000 Per Day.

Areas | Scope of Internal Audit in a Company :-

1. Independent Review and appraisal of Control systems across the organization (both financially & opertionally).

2. Checking all the Relevant compliance, Procedures, Regulations and legislations.

3. Facilitating a Good Practice in Management of Risks. This Requires systems for ascertaining, Measuring, Managing and eliminate the Risk, if Possible.

4. Achieve Savings by identifying waste, inefficiency and duplication of effort across the organization.

5. Structuring Programs and activities such that the Company's Assets are Safeguarded and there are internal check systems which Minimise the Possibility for Reducing Fraud and Provide early warning signals for identifying Fraud.

→ Preparation for an Audit :- following steps shall be followed for Performance of any Audit :-

① Defining the Scope of the Audit work i.e Preparation of the Audit Engagement letter.

② Obtaining the Knowledge of the client's business and formulating the Audit Programme.

③ Evaluation of the Accounting and internal control system existing in the Auditee enterprise.

④ Determining the nature, timming and extent of Audit Procedures keeping in Mind the Audit Risk and Materiality involved.

⑤ Adequate documentation is also necessary i.e Preparation of Audit note Book and working Papers.

⑥ Formulation of opinion about the financial statements.

⑦ Issuance of Audit Report.

→ Techniques to be used by Auditor to collect the Necessary Evidence :- Such Technique used by Auditor are as follows:-

1. Vouching.
2. Confirmations.
3. Physical Examinations and Verifications.
4. Analytical Procedures.
5. Test checking.
6. Inquiry.
7. Electronic data Processing.
8. Preparation of Reconciliation statements.
9. Flow charting.
10. Scanning.

→ **Audit Programme :** An Audit Programme is a detailed Plan of the Audit work to be Performed, Specifying the Procedures to be Followed in verification of Each item and the financial statements and the estimated time Required.

Advantages of Audit Programme :-

1. It serves as a Ready check list of Audit Procedures to be Performed.

2. The Audit work can be Properly allocated to the Audit assistants or to the Article clerks.

3. The Auditor may easily know the extent of work done at any Point of time.

4. A uniformity of the work can be attained as the same Programme would be Followed from time to time.

5. It is a useful basis for Planning the Programme for the Following Year.

6. It may be used as Evidence by the Auditor in the event when any charge is brought against him,

He can Prove that there is no negligence on his Part and he exercised reasonable care and skill while Performing the Task.

Disadvantages of Audit Programme :-

1. The Auditor's Task becomes mechanical and the auditors may lose Interest and Initiative.

2. Drawing up of an Audit Programme may be unnecessary for a Small concern.

3. Though Audit Programme helps in fixing Responsibilities but inefficient staff may defend themselves by stating that the matter was not contained in the Audit Programme.

4. Rigid Programmes cannot be laid down for each type of business.

An Example of Audit Programme :-

M/S ARIHANT TRADING PRIVATE LIMITED
Audit Programme for the Month / F.Y

Type of Audit — Statutory Audit / Tax Audit / Cost Audit etc.
Staff Involved

Particulars.	Remarks	Time Taken	Signature
obtained Management confirmation letter.			
Financial statements.			
Cost Statements.			
Annexures.			
Cash Flow statement, Etc.			

→ Continuos Audit and Final Audit :-

Continuos Audit : Continuos Audit involves the detailed examination of all the Transactions by the Auditor continuously through out the year at regular intervals whether Monthly, Quarterly, Half-yearly.

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

It involves the constant engagement of Auditor's staff at the client office throughout the Period under review.

Continuous Audit is suitable in cases where the Final Accounts are desired to be presented soon after the close of the F.Y or if there is great volume of Transactions or if the systems of Internal check is weak.

Final Audit : A Final Audit is also called as completed Audit or Periodical Audit. Final Audit is done after the close of the F.Y ie after the Books of Accounts have been closed.

In this type of Audit, the client Gives the Possession of Books of Accounts to the Auditor for Audit and Routine checking & other Audit Procedures begin only after that.

→ Audit working Papers :- Audit working Papers are the Record of the Planning and execution of the Audit engagement. Auditors retain a set of working Papers for each Audit engagement for Each year.

The Audit working Papers for the current Year are referred to as the current working Papers.

Working Papers that are relevant to more than one Audit engagement are often kept Separately in a file referred to as Permanent working Papers.

These Working Papers Serve following three Purposes :-

1. Aid in Planning and Performance of the Audit.
2. Aid in supervision and review of the Audit work.
3. And these Papers serve as an evidence of the Audit work Performed by the Auditor to support his opinion.

Forms and content of working Papers vary from Audits to Audits, but they depends on following Matters :-

1. Nature of Engagement.
2. Nature and complexity of client's business.
3. Nature and condition of client's Records.
4. Form of Audit Report.

(5) Supervision of work Performed by assistants.

(6) Degree of reliance of Internal controls.

→ Difference between Permanent Audit file and Current Audit file.

	Permanent Audit file	Current Audit file.
(1)	legal and organizational structure of the entity like MOA and AOA.	It is related to acceptance of Annual Reappointment.
(2)	Extracts or copies of legal documents, agreements and minutes relevant to the Audit.	Extracts of important matters in the minutes of Board meeting and General meeting relevant to the Audit.
(3)	A Record if study and evaluation of Internal Controls.	Copies of Management letters.
(4)	Analysis of Significant Ratios and Trends.	Analysis of Transaction and Balances.
(5)	Copies of the Audited Financial Statements of P.Y.	Copies of communication with other auditors, experts and third Parties.

⑥	Notes Regarding Significant accounting Policies.	It contains Audit Programme.
⑦	Significant Audit observation of the Earlier Years.	Conclusions reached on Significant aspects of audit.

→ Audit Note Book :- An Audit Note Book is usually a bound book in which a large variety of matters observed during the course of Audit are recorded. The Audit Note book is a Permanent record of the Auditor.

Contents of Audit Note Book are as follows :-

① Name of the business enterprise.

② Organisational structure.

③ Important Provisions of MOA and AOA.

④ Communication with Previous Auditor, if any.

⑤ list of Books of Accounts maintained by the enterprise.

⑥ Accounting Methods, internal control system, applicable laws.

⑦ Key Managerial Personnel.

⑧ Errors and fraud discovered, and other special points.

Specimen of Audit Note Book :-

M/s Star Private Limited
Audit Notes Book For the F.Y

Voucher No.	Account Involved.	Amount	Remarks (Query)	Solution. (as Per your) Judgement.
ST-31	Books of A/c	₹ 25000	Cash Payment	Disallow.
ST-45	Depreciable Assets	₹ 5500	Incorrect Rate of depreciation.	Impose correct Rate.
ST-51	TDS	₹ 10000	Not deducted.	Deduct & Pay.
ST-66	PF	₹ 22000	Not contributed.	Contribute & Pay.

→ Auditor's Engagement letter :- When the Auditors agree with the client's Management about the Scope, terms and conditions of the Audit engagement in writing then this written letter / communication is referred to as an engagement letter.

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

→ Example of Audit Engagement letter :-

To,
M/s XYZ & Co.
Cost Accountant or chartered Accountant

Subject : Audit Engagement letter related to Terms & condition.

Respected Sir / Mam,

This Representation letter is provided in Connection with your Audit of the Financial Statements of ABC Private limited for the Year ended 31.3.2022 for the Purpose of Expressing an opinion as to whether the Financial Statements Give a True and fair View of Financial Position or not.

Below is the Some Term and conditions :-

→ Objective & Scope of the Engagement.
→ Management's Responsibility.
→ Restriction on Auditor's liability, if any.
→ Audit fees Payable, etc.

Thanking You
ABC Private limited.

Director Name _____
DIN _____

Date _____

→ Role of CMAs in Internal Audit :-

① CMAs holds the expertise to evaluate the operational efficiency, Productivity and Profitability, wastages, losses and inefficiency.

② CMAs have a vital role to Play, as they have an unique blend of core competencies in Accounting, Management and in strategy.

③ CMAs can apply their forward looking insight across the organisation to manage risks, Reduce costs and create new opportunities, Preserve & enhance values.

④ The Perspective of CMAs have changed in the Present Era of Mergers and Acquisition, new Product development and also to climate change and substainability.

⑤ The Financial Perspective, Customer Perspective, operational Perspective and People Perspective, all can be aligned to meet the Goal of the business.

⑥ The Expectation of the BOD from Internal Auditors (CMAs) are now to assist the Board in Identification, Monitoring and Management of business Risks and also to offer and Provide insight, advice and assurance on enterprise risks.

(7) The Reputated CMAs as an Internal Auditor should also inform to BOD about the tone of the organization culture, ethics, Performance and continuously evaluate the efficiency and effectiveness of operations.

(8) CMAs should also check compliance with applicable laws and Regulations and should authenticate the reliability of Financial and Management Reporting.

(9) CMAs has the added role of Safeguarding the Assets of the company.

(10) They should evaluate Performance Management and Act as an advisor to the Management. The Role of effective Cost Management involves in waste reduction and enhancing Productivity and Process improvement.

Study Note 11 - Internal control, Internal Audit and operational Audit

PART (A) INTERNAL CONTROL :-

Internal control means identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment.

Internal control are certain checks and Procedures installed by the Management to prevent financial Fraud or Misappropriation of Assets.

→ Objectives of Internal Control :-

1. To Safeguards Corporate Assets.
2. To Ensure Accuracy and Reliability of data captured and information products.
3. To Promote efficiency.
4. To Measure compliance with corporate Policies.
5. To Measure compliance with Regulations.
6. To Manage the negative events and effects from fraud.

→ Types of Internal Control :-

① Administrative Control : Administrative controls includes all types of Managerial controls related to the decision Making Process.

② Operational Control : This is exercised through Management Accounting like Budgetary control, standard costing etc.

③ Financial and Accounting control : This control refers Primarily the Management plans, objectives and procedures that are concerned with the Safeguarding of Assets, Prevention and detection of fraud and error.

④ Compliance Control : These controls aim at ensuring compliance with applicable laws and Regulations. These controls also help to ensure compliance with laws regarding the system and intellectual Property.

→ Structure of Internal Control : Followings are to be considered as structure of Internal Control :-

① Types of business.

② Magnitude of the business.

③ Infrastructure Available in the organisations.

④ Potentiality of the human resources and their outlook.

→ Scope of Internal Control :-

① Reliability and Integrity of financial and Operating information : Internal Auditor should Review the reliability and integrity of financial and operating information and the means used to identify, measures, classify & Report such information.

② Compliance with laws, Policies, plans, Procedures and Regulations : Internal Auditor should review the systems established to ensure compliance with those Policies, Plan and Procedures, laws and Regulations.

③ Safe Guarding of Assets : Internal Auditors should verify the existence of Assets and should review the means of Safeguarding Assets.

④ Economic and efficient use of Resources : Internal Auditor should ensure the Economic and efficient use of Resource Available.

⑤ Accomplishing of Established objectives and Goals for operations : Internal Auditor should Review operation or programmes to ascertain whether results are consistent with established objectives and Goals.

→ Limitations of Internal control :-

① Costly : Design and implementation of Internal control is a costly affairs, Cost benefit analysis should be undertaken.

② No control for unusual transaction : Sometimes unusual or mislead Transaction Takesplace and not caught up by the Internal Auditor.

③ Human Error : Human Judgement in decision Making can be Faulty and that Breakdowns in Internal control which can occur because of human error.

④ Collusion among Employees : There may be Possibility of loopholes with controls through manipulation with Parties outside entity or within the entity's employee.

⑤ Abuse of Authority : The Possibility that a person Responsible for exercising control could abuse that Authority.

⑥ Inadequate Procedure : There may be Possibility that Procedures may become inadequate due to changes in conditions and compliance.

⑦ Manipulations by Management : There may be Manipulations by Management due to Misuse of Powers and Authority.

→ Evaluation of Internal Control :

① The Evaluation of Internal controls including internal accounting controls gives an opportunity to the Auditor for a clear insight into the operational systems and into an overall view of organizati-onal workings.

② It is because, Internal control spot weaknesses in the systems and Procedures regarding financial and operational areas of the business.

③ The Audit Process effectively evaluates the Auditee's existing internal controls through the use of Questionnaries and Flow charts.

④ The Audit committee shall have Powers to investigate any Activity within its terms of Reference, to seek information from any employee

⑤ There are Prescribed limit for company which have to established an Audit Committee to perform their Prescribed function Related to Audits.

Prescribed limit for Companies to Established an Audit Committee are as follows :-

1. All Public companies with a Paid up Capital of ₹10crore or more;

2. All Public companies with a Turnover of ₹100 crore or more ;

3. All Public companies, having in aggregate, outstanding loans or borrowings or debentures or debosits "exceeding" ₹ 50 crore or more as on the date of last Audited Financial statements.

Role | Prescribed functions of Audit Committee are as follows :-

1. To Evaluation of Internal financial controls and Risk Management systems.

2. To Reviewing the Performance of statutory & Internal Auditor and the adequacy of the Internal control systems.

3. To Reviewing the adequacy of Internal Audit function.

4. To Discuss all the relevant findings with the Internal Auditor.

5. To appoint, Remove and decide the Remuneration of the Internal Auditor.

6. To Discuss the nature & Scope of Audit with Statutory Auditors.

→ Internal Control and the Auditor :-

① On the basis of Audit work Performed, the Auditor may identify deficiencies in internal control, if any.

② The Auditor shall communicate in writing Significant deficiencies in Internal control identified during the Audit to those charged with Governance on a Timely basis.

③ The Auditor shall also communicate to Management at an appropriate level of Responsibility on a timely basis.

④ The Auditor shall include in the written commu-nication of Significant deficiencies found in the Internal Control :-

A) A description of the deficiencies and an Explanation of their Potential effects and

B) Sufficient information to enable those charged with Governance and Management to understand the context of the communication.

C) Auditor should Give his opinion on the financial statements of company.

→ Factors for Successful Internal Control :-

① Segregation and Rotation of Duties : It is very Necessary for Successful Internal control system that no one Person handles the complete Transaction.

② Competence and Integrity of People : Honest, competent and integrity Peoples are Necessary for Successful Implement-ation of Internal control.

③ Appropriate levels of Authority : A common error usually made is to grant too much Authority within control boundaries. However, controls to be effective require the Authority to be Granted on a Need-to have basis only.

④ Accountability : The Internal controls to be Successful Pre-Suppose that there is full Accountability for all the decisions Taken.

⑤ Adequate Resources : Company should enforced adequate resource in order to function it internal control Smoothly.

⑥ Supervision and Periodical updation : It is very Necessary for the controls to be adequately Supervised and Periodically updated in line with the change in the Environment for the effective and Successful Internal Control.

PART (c) OPERATIONAL AUDIT :- An operational Audit has been defined as an organized Search for ways of Improving efficiency and effectiveness.

The objective is to assist the organization in Performing functions more effectively and economically with focus on the efficiency and effectiveness of operations, it is also stated to be an Early warning system for the detection of Potentially destructive Problems.

Operations Audit is a Process to determine ways to improve Production. It falls into the category of a Management Service by Evaluating the four functions of Management, Namely :-

1. Planning.
2. Organizing.
3. Directing.
4. Controlling.

Difference between Internal Audit and operational Audit.

Internal Audit	Operational Audit
① Compliance objective.	Risk identification, Process improvement objective.
② Focus on Financial Accounts.	Focus on Business Activity.
③ Audit Focus.	Efficiency and improvement focus.
④ Transaction based.	Process based.
⑤ Policies and Procedures focus.	Risk Management focus.
⑥ Cost centre wise budget Monitoring.	Accountability for Performance improvement results.

→ Internal Audit in Different Sectors :-

(A) AUDIT OF HOSPITALS :- The following Points are to be considered necessary for Conducting an Audit of a Hospital :-

(1) Check the letter of appointment to ascertain the Scope of Responsibilities.

(2) check the Registration including charter or Trust deed.

(3) Verify the System of Internal check, Internal control.

(4) Verify the enteries in the Patient's Bill Register with a copies of bill issued. And check them with the Period of stay of each Patient as recorded in the attendance schedule.

(5) Ascertaining that arrears of dues should be Properly carried forward and where these are deemed to be irrecoverable, they should be written off.

(6) Ensuring that Interest or dividend income should be recorded as separate in the Investment Register.

(7) Ensuring that Income from donations should not be applied in Purpose other than charity.

(8) Ensuring that there should be clear distinction between the items of capital and Revenue nature.

(9) Examine that the appointment of the staff, Payments of Salaries etc. are duly authorised.

(10) Physically verify the Investments, fixed Assets & inventories.

(11) Check that adequate depreciation has been Provided on all the depreciable assets.

(B) AUDIT OF HOTELS :- The business of Running a hotel is very much different to running an Industrial unit for Manufacturing of Products. It is a Service-oriented Industry.

The business is characterized by handling of large amounts of liquid Cash, stock of Foods, providing a variety of Services and keeping watch on customers to ensure that they do not leave hotels without settling the dues.

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

(1) Internal Control :- The following Matters should be check :-

a) Effectiveness of arrangement regarding receipts and distribution of Cash.

b) Procedures for Purchase and stocking of Various commodities.

c) Procedures regarding biling of the customers in respect of Room Services, Telephone, laundry etc.

d) System regarding recording and Physical custody of edibles, wines, cigarettes, crockery, furniture, etc.

e) Ensure that Trading Accounts are Prepared for each Sales and a Scrutiny of the percentage of profit should be made.

② Room Sales and Cash collection :- Verify the following Matters:-

a) Ensure that Price charged from customer should be accurate and matched with Actual Stay Period.

b) There should be adequate Policy for Cash Transactions.

c) The Total sales reported with the Total bills issued at each Sales point have to be Reconciled.

d) Biling should be done Room-wise, it must be ensured that all customers Pay their bills on leaving the hotel or within specified dates.

② Stock :- The stock in a hotel are all saleable item like food and beverages. Therefore, following item may be noted in this Regard :-

a) All movements and Transfer of stocks must be Properly documented.

b) Areas where stocks are kept must be properly locked and all the keys must be retained by the department Manager.

c) The key should be released only to Trusted Personnel.

d) The Auditor should ensure that all stocks are valued at the year and Auditor should himself Present at the year end Physical verification.

(4) Fixed Assets :- The Fixed Assets should be Properly depreciated, and the Fixed Assets Register should be updated.

(5) Casual labour :- In case, the hotels employs a Casual labour, the auditor consider whether adequate records have been maintained in this respect and there is no manipulation Taking Place.

And the wages Payment of the casual labour must also be checked throughly.

(6) Compliance :- The compliance with all statutory Provisions and compliance with the foreign exchange Regulations must also be verified by the Auditor.

It is because Hotels offer facility of conversion of foreign exchange to Rupees (due to foreign Tourist comes to India.)

(c) AUDIT OF EDUCATIONAL INSTITUTIONS :- following Verification shall be Taken :-

(1) first of all check the Registration and Trust deed.

(2) Read through the minutes of the meetings of the Managing committee or of Governing body.

(3) check names entered in the student's fee register for each term with the respective class register, showing name of students on rolls and test check amount of fees charged.

(4) Verify that free studentship and concession have been granted to a student who fulfill eligible criteria.

(5) Confirms that fines for late Payment or absence etc, have either been collected under Proper Authority.

(6) Verify Rental Income from landed Property with the Rent Rolls.

(7) Verify Government or local authority grant with the relevant Papers of grant.

(8) Report any old heavy arrears on account of fees to the Managing committee.

(9) See that increase in the Salaries of the Staff have been Sanctioned and approved by the Committee.

(10) Verify the annual statements of accounts and see that separate statements of Accounts have been Maintained for Game

funds, Poor boys funds, Provident funds etc.

(D) AUDIT OF CO-OPERATIVE SOCITIES :- following Matters shall be Verified :-

(1) Examination of overdue debts :- Overdue debts for a Period of from Six months to five years and more than five years will have to be classified and shall have to be reported by an Auditor because its affects its working capital Position.

They will have to be classified as Good or bad. The auditor will have to ascertain whether Proper Provisions for doubtful debts is made and whether it is Satisfactory or not.

The Percentage of overdue debts to the working capital and loan advanced will have to be compared with last year, so that Necessary Action shall be Taken.

(2) Overdue Interest :- Over due interest should be excluded from Interest outstanding and accrued due while calculating Profit.

Over due Interest is Interest accrued or accruing in accounts, the amount of which the Principal is overdue.

③ Certification of Bad debts :- Bad debts and irrecoverable losses before being written off against Bad debts funds, Reserve funds etc. should be certified as bad debts or irrecoverable losses by the auditor.

④ Valuation of Assets and Liabilities :- The Auditor will have to ascertain existence, ownership and valuation of assets. Fixed assets should be valued at Cost less adequate Provision for depreciation. The Incidental expenses incurred in the acquisition and the installation expenses of assets should be Properly capitalised.

⑤ Adherence to co-operative Principles :- The Auditor will have to ascertain in general, how the objects for which the co-operative organisation is set up, have been achieved in the course of its working. while Auditing the expenses, the Auditor should see that they are economically incurred and there is no wastage of funds.

⑥ Verification of Member's Register and examination of their Pass Books :- Examination of entries in Members Pass Book regarding the loan Given and its Repayment, and confirmation of loans balances in Person is very much important in a co-operative organisation to assure that the enteries in the Books of accounts are free from Manipulation.

(E) AUDIT OF SELF-HELP GROUP :- Self help Group (SHG) Movement in India has been recognised as an effective strategy for Mobilization and empowerment of rural People, particularly Poor women and other Marginalized Groups.

Following Matters shall be verified during an Audit :-

(1) Back Ground Review :- During a back Ground review, a preliminary examination of the group level records (included Cash Book) shall be conducted. The Auditor also does a general review of the group level records and member passbook to verify data enteries for their accuracy and correct Posting.

(2) Prepare field Balance sheet :- The Auditor prepares the field Balance sheet for the SHG as on the date of Audit based on the SHG's internal Records and then verify the correctness of balance sheet items. The Primary objective is to ascertain the retained earnings of the SHG.

(3) Private Meetings with Members :- The auditor should conducts Private interview with Min. 25% of Total Members to Triangulate information collected from the background review as well as from the field Balance sheet, to ascertain the decision Making Pattern in the Group.

(4) Meeting with the SHG Group :- If Serious issues were raised during the course of the Audit, the Auditor will meet with the entire Group for further discussion.

(5) Reporting :- Once the Audit is completed then the Auditor summarises any weak Practices that Put savings at risk or Make records unreliable and Recommends any better Methods.

(F) AUDIT OF NON-GOVERMENTAL ORGANISATION (NGOs) :- while Planning the Audit of a NGO, following Matters shall be verify :-

(1) Knowledge of the NGO's work, its Mission and vision, areas of operations shall be examined.

(2) Reviewing the legal form of the organisation and its MOA, AOA, Rules and Regulations.

(3) Reviewing the NGO's organisation chart, financial and Administrative Manuals.

(4) Examination of minutes of the Board / Managing committee Governing body and of Management of the NGO.

(5) Study the Accounting system, Procedures, internal controls and internal checks existing for the NGO and verify their applicability.

The Audit Programme should also include Verification of all assets, liabilities, income and expenditure in the following sequential order :-

1. Corpus fund.
2. Reserves.
3. Era-Marked funds.
4. Project Balances.
5. Loans.
6. Fixed Assets.
7. Investments.
8. Cash in hands.
9. Bank Balance.
10. Stock in hand.
11. Programme and Project Expenses.
12. Establishment Expenses.
13. Contribution and Grants for Projects and Programmes.
14. Receipts from fund arising Programmes.
15. Membership fees.
16. Subscription.
17. Interest and Dividends.

(G) AUDIT OF LOCAL BODIES :- local bodies are Institutions of local Self Governance, which look after the administration of an area or small community such as villages, Towns, or cities.

The local Bodies in India are broadly classified into two categories namely :-

→ Rural local Bodies (Panchayats) : which constituted for local Planning, development and administration in Rural Areas.

→ Urban local Bodies (Municipalities) : which constituted for local Planning, development and administration in urban Areas.

Following Matters shall be verify during an Audit :-

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

② Expenditure Control :- At State and central level, there is a clear democration between the legislature and executive. In the local body, legislative Powers are vested in the council where as executive Powers are delegated to the Commissioners. All matters of Regular revenue and expenditure are generally delegated to the executive wing.

③ Accounting System :- Municipal Accounting System has been conventionally Prepared under the Cash basis. In recent Past, it is being changed to the accrual system of accounting. The accounting system is characterised by :-

a) Subsidiary and statistical registers for Taxes, Assets etc.

b) Separate vouchers for Each type of Transaction.

c) Compulsary monthly Bank Reconciliation.

d) Submission of Summary Reports on Periodical basis.

Objectives of Audit are :-

a) To report the content and Presentation of financial statements are True and fair.

b) Detection and Prevention of error, fraud, Misuse of funds.

c) To ascertain that full value received for money spent.

d) legal and administrative requirements should be fulfilled.

(H) GOVERNMENT EXPENDITURE AUDIT :- Following Matters shall be verified in this Regard :-

(1) Audit against Rules & order :- The Auditor has to see that the expenditure incurred conforms to the relevant Provisions of the statutory entactment and is in accordance with the financial rules and Regulations framed by the competent authority.

(2) Audit of Sanctions :- The Auditor has to ensure that each item of expenditure is covered by a Sanction, either general or special by competent authority.

(3) Audit against Provisions of funds :- Ensure that there is a Provision of funds out of which expenditure can be incurred and the amount of Such expenditure doesnot exceed the appropriations made.

(4) Propriety Audit :- The Auditors aims to bring out the cases of improper, avoidable or infructuous expenditure even they are duly Sanctioned or not.

(5) Performance Audit :- Objective of this Audit is examination of the financial and operational Performance of an organisation, Programme, authority or function and is to oriented towards identifying opportunities for greater economy and effectiveness.

Role of C & AG (Comptroller and Audit General of India) in the Audit of a Government company:-

① The Auditor of a Government company is appointed by the C&AG of India.

② The C&AG have Powers u/s 143 of Companies Act, 2013 as follows :-

a) To direct the Manner in which the company's Accounts shall be audited by the Auditor and to issue necessary Guidelines and Instructions.

b) To conduct a Test Audit of the company's Accounts by a Authorised Person by it.

c) To demand additional necessary Information for implementation of Such Test Audit

Properiety Audit in the context of Government Audit :-

Under the Properity Audit, the Auditor try to bring out the Cases of improper, avoidable or Infructuous expenditure even these expenditures are Sanctioned by competent Authority or not.

In this Regard, Following Matters shall be verify :-

1. The expenditure should not be Prima Facie more than the occasion demands.

2. No Authority should exercise its Powers of Sanctioning expenditure to Pass an order which will be directly or indirectly to its own advantage.

3. Public moneys should not be utilised for the benefit of a Particular Person or the community unless :-

a) the amount of expenditure involved is insignificant, or

b) a claim for the amount could be enforced in a Court of law, or

c) the expenditure is in Pursuance of a Recognised Policy.

(I) AUDIT of COMMERCIAL ACCOUNTS :- The Government also engages in commercial activities and for the Purpose it may incorporate following Types of entities :-

(1) Departmental enterprises engaged in commercial and Trading operations, which are governed by the same regulations as other Government departments.

(2) Statutory corporation created by Specific Statues such as LIC, Air India etc.

(3) And the Government companies set up under the Companies Act, 2013, for the Purpose of conduct of Audit.

Case Study on Performance Analysis.

→ RATIO ANALYSIS :

(A) Profitability Ratio :-

(1) Gross Profit Ratio $= \frac{\text{Gross Profit}}{\text{Net Sales}} \times 100$

(2) Operating Ratio $= \frac{\text{Operating expenses}}{\text{Net Sales}} \times 100$

(3) Operating Profit Ratio $= \frac{\text{Operating Profit}}{\text{Net Sales}} \times 100$

(4) Net Profit Ratio $= \frac{\text{PBT}}{\text{Net Sales}} \times 100$

(5) Expenses Ratio $= \frac{\text{Expenses}}{\text{Net Sales}} \times 100$

(6) Return on Investment ROI or ROC $= \frac{\text{Earning before interest and after Tax}}{\text{Average Capital employed.}}$

(7) Return on equity / on Networth. $= \frac{\text{PAT or Total Earning}}{\text{Shareholder's fund or Networth.}}$

Use as :-

$ROE = \frac{EAE}{\text{Shareholder's fund}}$, $RONW = \frac{PAT}{\text{Networth}}$

(B) ACTIVITY RATIOS :-

(1) Inventory Turnover Ratio $= \frac{\text{Net Sales}}{\text{Average Stock}}$ or $\frac{\text{COGS}}{\text{Average Stock}}$

(2) Debtors Turnover Ratio $= \frac{\text{Average Receivables}}{\text{credit Sales}} \times$ No. of days in the year.

or $\frac{\text{Credit Sales}}{\text{Average Receivables}}$

(3) Creditors Turnover Ratio. $= \frac{\text{Average Payable}}{\text{credit Purchase}} \times$ No. of days in the year.

(4) Fixed Assets Turnover Ratio $= \frac{\text{Net Sales}}{\text{Fixed Assets.}}$

(5) Working Capital Turnover Ratio $= \frac{\text{Sales (Net)}}{\text{Working Capital.}}$

(6) Capital Turnover Ratio $= \frac{\text{Net Sales}}{\text{Average Capital employed.}}$

(7) Total Assets Turnover Ratio $= \frac{\text{Net Sales}}{\text{Total Assets}}$

(c) Solvency Ratios : Long Term Solvency Ratios :

(1) Debt Equity Ratio $= \frac{\text{Total outside Liability}}{\text{Net worth.}}$

(2) Proprietary Ratio $= \frac{\text{Shareholder's fund}}{\text{Total Assets.}}$

Total Asset may be $=$ FA + (CA − CL)

(3) Fixed Assets Ratio $= \frac{\text{Net Fixed Assets}}{\text{Long term funds}}$

(4) Capital Gearing Ratio $= \frac{\text{Debt}}{\text{Debt + Equity.}}$

(D) Solvency Ratio : Short term Solvency Ratios :

(1) Current Ratio = $\frac{\text{Current Assets}}{\text{Current liabilities}}$

(2) Liquidity Ratio = $\frac{\text{Liquid Asset}}{\text{Current Liabilities. / Liquid liabilities.}}$

(3) Interest Coverage Ratio = $\frac{\text{EBIT}}{\text{Interest Expenses.}}$

Liquid Asset = CA - Inventory - Prepaid expenses

Liquid Liabilities = CL - Bank OD - Cash credit

→ WASTE MULTPLIER :

① In many continuous Process industries cost data are arrived at with Complexity in the Calculation.

② A spinning unit of Cotton Textile Industry has set of processing departments like Mixing and Blow Room, Carding, Drawing, Combing, Fly Frames and Ring Frames.

③ Actually Spinning unit comes under continuous Process Industry.

④ Mixing and Blow room are the Starting Point when the raw Material cottons enters and comes out as a yarn in the Ring Frame Section.

⑤ Obviously like every Processing industry in Spinning mills certain amount of wastages is emerging out of Production in each and every department.

⑥ It is Segregated as usable waste and Saleable waste apart from invisible loss.

⑦ while the usable waste and Saleable waste can be Measured Physically, the invisible loss is found out from the input & output of Raw Materials after Considering due weightage of Saleable and usable waste.

⑧ The Actual waste which is extracted from the Machine Process depends upon the impurities in the cotton. Thus, the Production Process involves wastage has a Routine or a cycle.

(9) Waste Multiplier is that Quantity of Output from any Process, which will be needed to get one unit of final output.

(10) The formula to calculate Process wise waste Multiplier is as follows :-

$$= \frac{\text{Concern Process output}}{\text{Final output}}$$

→ Computation of Average Capital Employed :-

Particulars.	C.Y (₹)	P.Y (₹)
Net Fixed Asset	xxxx	xxxx
Non-current Investment	xxxx	xxxx
Current Assets	xxxx	xxxx
Total (A)	xxxx	xxxx
less : Current liabilities	(xxxx)	(xxxx)
Total Capital Employed	xxxx	xxxx

∴ Average capital employed $= \frac{\text{C.E of C.Y} + \text{C.E of P.Y}}{2}$

Note :- Any Amount of Revaluation Reserve shown in Balance sheet or shown in additional information and includes in any Asset shall be Reduced from C.E.

And Capital employed ignore the following :-

1. Capital WIP.
2. Current Investment (Hint → if Question is silent then assume Given investment as current and ignore).
3. Investments in others Companies (including Subsidiary).
4. Investments in Building etc. not used for business.
5. Preliminary Expenses. (but it is considered for computation of Net worth).
and debit balance of Profit and loss Account.

→ Computation of Networth :-

Particulars.	(₹)
Paid up share Capital	xxxx
Reserves & Surplus (except Revaluation Reserves and includes credit balance of Profit and loss A/c) made out of Profits.	xxxx
less: Accumulated losses (including debit balance of Profit & loss A/c)	(xxxx)
Net Worth.	xxxx

→ Computation of changes in Networth :

Particulars.	(₹)
Operating Net worth	xxxx
Add : Increase in share Capital	xxxx
Increase in Reserves	xxxx
	xxxx
less : Decrease in share Capital	(xxxx)
Decrease in Reserves	(xxxx)
Closing Net worth.	xxxx

→ Computation of Net Sales :-

Particulars.		(₹)
Gross Sale Value		xxxx
less : following items, if included :-		
Sales Return	xxxx	
Indirect Taxes	xxxx	
Octroi / Local Taxes	xxxx	
Proceed from Scrap or waste.	xxxx	
Recoverable Packing or Transport charges etc.	xxxx	(xxxx)
Net Sales.		xxxx

→ Computation of PBT :-

by Direct Method.		by Indirect Method.	
Sale / Revenues	₹ xxxx	PAT	₹ xxxx
less: All expenses except Income Tax	(₹ xxxx)	Add : Income Tax	₹ xxxx
PBT	₹ xxxx	PBT	₹ xxxx

→ Computation of operating Profit (EBIT) :-

by Direct Method		by Indirect Method.	
Operating Revenue	₹ xxxx	PBT	₹ xxxx
less: operating Expenses (except interest and Income Tax)	(₹ xxxx)	Add : Interest	₹ xxxx
		EBIT	xxxx
EBIT	₹ xxxx		

→ Computation of Value Addition :-

Particulars.	(₹)
Net Sales	xxxx
Add: Export Incentive, if any	xxxx
Add / less : Adjustment of Finished Stock	xxxx / (xxxx)
	xxxx
less : Cost of bought out inputs :	
Cost of Material Consumed xxxx	
Process Material / chemical xxxx	
Consumption of Stores and spares xxxx	
utilities (like Power & fuel) xxxx	
others cost, if any xxxx	(xxxx)
Value Addition.	xxxx

Note : Ignore the following in Computation of Value Addition :-

1. Rates and Taxes. (not Rent, Rate and Taxes)
2. Depreciation.
3. All Salaries and wages.
4. Interest (except Interest on working capital)

→ Statement showing Distribution of Earnings to different heads :-

Particulars.	(₹)
Value addition	xxxx
Add : other Income	xxxx
Add : Extra ordinary income	xxxx
Total Earnings Available for distribution.	xxxx

Now,

Distribution of Earnings to :-

→ Employees as Salaries and wages, Retirement benefit, bonus, etc.	xxxx
→ Shareholders as Dividend.	xxxx
→ Government as Any Tax (including Rates and Taxes)	xxxx
→ Extra ordinary expenses (not deducted in value addition)	xxxx
→ others, if any	xxxx
Retained Earning (b/f)	xxxx
Total Earnings Available for distribution.	xxxx

PROFESSIONAL MISCONDUCTS

THE FIRST SCHEDULE

PART I

PROFESSIONAL MISCONDUCT IN RELATION TO COST ACCOUNTANTS IN PRACTICE

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

(1) allows any person to practice in his name as a cost accountant unless such person is also a cost accountant in practice and is in partnership with or employed by him;

(2) pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

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

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

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

(4) enters into partnership, in or outside India, with any person other than a cost accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (iv) of sub-section (1) of section 4 or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships;

(5) secures, either through the services of a person who is not an employee of such cost accountant or who is not his partner or by means which are not open to a cost accountant, any professional business:

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

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

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

(i) any cost accountant from applying or requesting for or inviting or securing professional work from another cost accountant in practice;

(ii) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;

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

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

(8) accepts a position as cost accountant previously held by another cost accountant in practice without first communicating with him in writing;

(9) charges or offers to charge, accepts or offers to accept in respect of any professional employment, fees which are based on a percentage of profits or which are contingent upon the findings or results of such employment, except as permitted under any regulation made under this Act;

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

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

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

PART II

PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE IN SERVICE

A member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person—

(1) pays or allows or agrees to pay, directly or indirectly, to any person any share in the emoluments of the employment undertaken by him;

(2) accepts or agrees to accept any part of fees, profit or gains from a lawyer, a cost accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

PROFESSIONAL MISCONDUCTS

PART III

PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

(1) not being a fellow of the Institute acts as a fellow of the Institute;

(2) does not supply the information called for, or does not comply with the requirements asked for by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

(3) while inviting professional work from another cost accountant or while responding to tenders or enquiries or while advertising through a write up, or anything as provided for in items (6) and (7) of Part I of this Schedule, gives information knowing it to be false.

PART IV

OTHER MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if—

(1) he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;

(2) in the opinion of the Council he brings disrepute to the profession or the institute as a result of his action whether or not related to his professional work.

Raghav ACADEMY

PROFESSIONAL MISCONDUCTS

THE SECOND SCHEDULE

PART I

PROFESSIONAL MISCONDUCT IN RELATION TO COST ACCOUNTANTS IN PRACTICE

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

(1) discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client, or otherwise than as required by any law for the time being in force;

(2) certifies or submits in his name, or in the name of his firm, a report of an examination of cost accounting and related statements unless the examination of such statements has been made by him or by a partner or an employee in his firm or by another cost accountant in practice;

(3) permits his name or the name of his firm to be used in connection with an estimate of cost or earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast;

(4) expresses his opinion on cost or pricing statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest;

(5) fails to disclose a material fact known to him in a cost or pricing statement, which is not disclosed in a cost or pricing statement but disclosure of which is necessary in making such statement where he is concerned with such statement in a professional capacity;

(6) fails to report a material mis-statement known to him to appear in a cost or pricing statement with which he is concerned in a professional capacity;

(7) does not exercise due diligence, or is grossly negligent in the conduct of his professional duties;

(8) fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion;

(9) fails to invite attention to any material departure from the generally accepted procedure of costing and pricing applicable to the circumstances;

(10) fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

Raghav ACADEMY

PART II

PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

(1) contravenes any of the provisions of this Act or the regulations made there-under or any guidelines issued by the Council;

(2) being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment, except as and when required by any law for the time being in force or except as permitted by the employer;

(3) includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false;

(4) defalcates or embezzles moneys received in his professional capacity.

PART III

OTHER MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.]

Raghav ACADEMY

CAS ILLUSTRATIONS

COST ACCOUNTING STANDARD 1

ILLUSTRATION 1.

There was a strike from 13.09.2017 to 16.11.2017 in a company of which you were the Cost Auditor for the yearending 31.03.2018. Although the company began working from 17.11.2017, production could effectively begin only from 5.12.2017. The expenses incurred during the year ended 31.03.2018 were:

	(Rs. in lakhs)
Salaries & Wages (direct)	450
Salaries & Wages (indirect)	300
Power (variable)	180
Depreciation	270
Other Fixed Expenses	360

Detailed examination of the records reveals that of the above, the following relate to the period 13.09.2017 to 16.11.2017:

	(Rs. in lakhs)
Salaries & Wages (indirect)	105
Depreciation	90
Other Fixed Expenses	135

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

Answer: **Calculation of Fixed expenses incurred during the period 17.11.2017 to 04.12.2017**

	Rs. in lakhs
Total expenses 2017 - 18	**1,560**
Less: Variable expenses (Electricity)	**180**
Fixed expenses (2017 - 18)	**1,380**
Less: Fixed expenses during the strike period	**330**
Fixed expenses during non-strike period	**1,050**

Since the strike period was for 65 days, the non-strike period is 300 days. Hence, Fixed expenses attributed to 18days, i.e., 17.11.2017 to 4.12.2017 is 6% of Rs.1,050 lakhs = Rs.63 lakhs.

Therefore, Expenses incurred during 13.9.17 to 16.11.17 Rs. 330 lakhs

For expenses incurred during 17.11.2017 to 04.12.2017 Rs. 63 lakhs

Total Rs. 393 lakhs

Hence, Rs. 393 lakhs is to be treated as abnormal cost and should be excluded from the product cost.

ILLUSTRATION 2.

You are the Internal Auditor of Arena Manufacturing Ltd. The Managing Director has asked you to enquire intothe cause of abnormal wastage of raw materials during the month of April. The wastage percentages for the last few months are: Jan. — 1.3%, Feb. — 1.1%, Mar. — 1.3% and Apr. — 3.9%. How will you proceed to carry out theassignment?

Answer:

The rate of wastage in the month of April is about 3 times than that of the previous months. Hence, it may be considered as abnormal. In respect of audit of abnormal wastage, the Auditor should proceed on the followinglines —

1. **General:**

   (i) Procure a list of Raw Materials, showing the names and detailed characteristics of each Raw Material.

   (ii) Enquire whether there is any change which will affect material wastage, e.g. changes in - (I) source of supply of raw materials, (II) methods or process, (III) operating condition of machines, (IV) labour force
   i.e. replacement of experienced employees by raw hands etc.

   (iii) Enquire whether any new production line was taken up during the month in respect of which standard Input-Output Ratio is yet to be set up.

2. **Wastage Figures:**

   (i) Obtain the standard consumption figures, and ascertain the basis of computation of normal wastagefigures.

   (ii) Examine whether the basis adopted for wastage calculation for the month of April is the same as that adopted for the other three months.

   (iii) See the breakup of normal wastage - (I) transit, (II) storage, (III) handling, and (IV) processing.

   (iv) Obtain a statement showing break up of wastage figures, (as above) for the four months under review
   and compare the results of the analysis for each of the four months.

3. **Consumption Records:** Examine the following to find out material variances / deviations if any -

   (i) Purchase of various lots,

   (ii) Identification of each lot with actual material consumption, and

   (iii) Ascertaining actual wastage figures.

4. **Abnormal Process Loss:**

   (i) Material Quality: Examine inspection and testing reports to find out if raw material purchased are of poor quality or sub-standard. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.

   (ii) Machine Utilisation: Machine breakdown, power failure, etc. may also result in loss of materials in
   process. Check Machine Utilisation Statements.

   (iii) Inspection: A high rate of rejection in the finished lots may also be responsible for abnormal wastage. Examine the Inspection Reports for the inspection carried out on the completion of each stage of work or process.

   (iv) Old Lot Consumption: It is possible that the wastage may have occurred because, the particular lot out of which issues were made in April was lying in the store for a long time, leading to deterioration in quality, or because of a change in weather, which may have led to the deterioration.

   (v) Previous period comparison: Compare the wastage figures of April this year with that of April last year and see whether there is any correlation.

5. **Abnormal Storage and Handling Loss:** This can happen due to -

(i) Write-offs on account of reconciliation of physical and book-stocks. In case of periodical physical stock-taking, such write offs will be reflected only in the month in which reconciliation takes place.

(ii) Accidental, theft or fire losses in storage. The Auditor should examine such possibilities.

CAS ILLUSTRATIONS

ILLUSTRATION 3:

The following is a summary of the Profit and Loss Account of M/s. Straw BerryCompany Limited for the year ended 31.03.2017 (Rs. in lakh):

Sales		**13,540**
Cost of Sales: Raw Materials, Stores, Spares	**5,600**	
Excise Duty	**830**	
Salaries, Wages	**1,400**	
Power and Fuel	**470**	
Repairs: Major Breakdown	**35**	
Regular Maintenance	**94**	
Selling and Distribution Cost	**1,040**	
Insurance	**56**	
Rent, Rates and Taxes	**97**	
Printing, Stationery, etc.	**437**	
Travelling	**776**	
Other Administrative expenses	**426**	
Depreciation	**391**	
Interest	**1,494**	
Total expenses		**13,146**
Profit		**394**

There was a major breakdown of machinery, resulting in loss of production for 42 days in June and July, 2016 and there was a labour strike of 97 days from 14.02.2017 to 21.05.2017. The company produced a single product (Steel-Billet) and the production during the year was 9,42,000 kgs. You are required to compute the amount of abnormal cost on account of the breakdown and strike and the impact on cost perunit of output. Where, do these figures find a place in the Cost Audit Report?

ANSWER:

Loss of working days due to abnormal situation are :Breakdown 42 days -Salary Paid

Strike 46 Days (up to 31st March , 2017) - No Salary PaidTotal 88 Days,

(Rs. in Lakh)

Income	**13,450**
Variable Exp : Raw Materials stores 5,600	
Excise Duty 830	
Power Fuel 470	**6,900**
Margin	**6,640**
Fixed Cost (13,146 -6900)	**6,246**

Salaries amounting to Rs. 1,400 Lakh is for (365-46) = 319 Days

Abnormal cost comes to

Fixed Cost on PRODUCTION	Total(Rs.)	Abnormal (Rs.)	**Normal (Rs.)**
Breakdown Repairs	35	35	**00**
Salaries Wages (in the ratio 42:319)	1400	184	**1216**
Interest	1494	00	**00**
Selling Distribution Cost	1040	00	**00**
Production Fixed Cost (Balance figure in the ratio 88:365)	2277	549	**1728**
Total	6246	768	**2944**
Production Cost Per Kg : (942000Kg)	**Variable = 6900/9.42 = Rs. 732.48**	**Fixed Cost 2944/9.42 = Rs. 312.52**	**Abnormal Cost = 768/9.42 = Rs. 81.52**

Note :

1. Interest, Selling charges are not included in the Cost of Production.
2. Abnormal Cost is excluded from Cost of Sales and charged to Profit & Loss Account
3. In the Cost Accounting Policy declared in Annexure to Cost Audit Report „A", the treatment of abnormal or non-recurring cost has to be declared
4. The analysis of value addition and distribution of Earnings show Extra ordinary expensesas post Value Addition.

CAS ILLUSTRATIONS

ILLUSTRATION 4:

Goodyear Automotives Ltd., located in a coastal state, had faced interruption in production during the year 2016-17 due to cyclone and flood. Out of total 303 available working days during the year, the interruptions were: (a) Flood: 4 days, (b) Cyclone: 3 days, and (c) Damage Restoration: 2 days (these exclude weekly off daysfalling in between). The unit declared lay-off during such period on payment of average 50% wages for direct workers. The damage to the plant and the cost of its repairs amounted to Rs. 87 million. Find out the abnormal expenses deductible from the product cost on the basis of the following expenses incurred in the FY 2016-17:

Amount in millions

Direct Wages & Salaries	**1230**	**Indirect Wages & Salaries**	**740**
Power	**820**	**Depreciation**	**210**
Other Fixed Expenses	**490**	**Finance Charges**	**115**

ANSWER:

As per CAS 1, Abnormal Cost is defined as atypical or an unusual cost due to some abnormal situation in case of production or operation. Any abnormal cost is excludedfrom total cost of production. In the present case, the following expenses are excluded from the total expenses:

1) The Finance Charge is not charged to Cost of Production but is to be shown under the head ‗Cost of Sales' (CAS 17).
2) Power is a direct cost and is excluded from the total expenses.
3) Direct wages and salaries is a variable cost but, in the given situation, the layoffpayment was made and hence is treated as fixed cost.
4) Depreciation is treated as fixed cost by its very nature (number of days ofworking).

Accordingly, the abnormal expenses for the year comes to:

		Rs. in million
Lay off payment (1230 x 9 / 303 x 0.5)		**18.27**
Restoration Cost of plant damages & repairs		**87.00**
Indirect Wages & Salaries	740	
Other Fixed Expenses	490	
Depreciation	210	
	1440	
The abnormal expenses will be = 1440 x (9/303)		**42.77**
Total : (Lay-off payment + Restoration Cost of plantDamage & repairs + Abnormal Expenses)		**148.04**

CAS ILLUSTRATIONS

ILLUSTRATION 5:

You are the Cost Auditor of INDIA JUTE MILLS LTD .for the year ended March 31, 2011. The company had a strike from 15.9.2010. Although the company resumed working from 18.11.2010, normal production was achieved only from 12.12.2010. The expenses incurred during the year ended March 31, 2011 were:

	(Amount in Rs. lakh)
Salaries and wages (Direct)	**450**
Salaries and wages (Indirect)	**220**
Power (Variable)	**160**
Depreciation	**140**
Other fixed expenses	**260**

Detailed examination of the records revealed that of the above, the following relate to the period15.9.2010 to 17.11.2010:

(Amount in Rs. lakh)

Salaries & wages (Indirect)	**80**
Depreciation (Non- productive)	**50**
Other fixed expenses	**110**

REQUIRED: As a Cost Auditor you are requested to calculate abnormal cost which will be excluded from the product cost.

Raghav ACADEMY

ANSWER:

INDIA JUTE MILLS

Calculation of fixed expenses incurred during the period : 18.11.2010 to 11.12.2010:

(Amount in Rs.Lakh)

Total Expenses for 2010-2011	**1230**
***Less* : Variable Expenses (Electricity)**	**160**
Fixed Expenses for 2010-11	**1070**
***Less :* Fixed expenses during strike period**	**240**
Fixed Expenses during non strike period	**830**
Since strike period was for 64 days (15.9.2010 to 17.11.2010)	
the non-strike period is 301 days .	

Hence Fixed expenses attributed to 24 days i.e.

18.11.2010 to 11.12.2010 is 7.97% (24÷301×100) of Rs.830 lakh = Rs.66.15 lakh

(Amount in Rs. Lakh)

Expenses incurred during the period of 15.9.2010 to 17.11.2010	240.00
Expenses incurred during the period of 18.11.2010 to 11.12.2010	66.15
Total	306.15

Hence Rs. 306.15 lakh is to be treated as Abnormal Cost and should be excluded from Product Cost.

ILLUSTRATION 6:

You are the Cost Auditor of MERLIN TEXTILE MILLS LTD. for the year ended March 31,2015.

The Company had a Strike from 16.09.2014 to 19.11.2014. Although the company resumed working from 20.11.2014 normal production was achieved only from 08.12.2014. The expenses incurred during the year ended March 31, 2015 were

Amount in Rs. Lakh

Salaries and Wages (Direct)	**1,800**
Salaries and Wages (Indirect)	**1,200**
Power (Variable-90%)	**600**
Depreciation	**1,080**
Other fixed expenses	**1,320**
Repairs and Maintenance (Variable-80%)	**600**

CAS ILLUSTRATIONS

Detailed examination of the records reveals that of the above, the following relate to the period 16 09.2014 to 19.11.2014.

Amount in Rs. Lakh

Salaries and Wages (Direct)	**Nil**
Salaries and Wages (Indirect)	**480**
Depreciation (Non-productive)	**300**
Other fixed expenses	**660**
	1,440

REQUIRED:

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

ANSWER: MERLIN TEXTILE MILLS LTD.

CALCULATION OF FIXED EXPENSES INCURRED DURING THE PERIOD 20.11.2014 TO 07.12.2014

(Amount in Rs. Lakh)

Total Expenses for 2014-15		6,600
Less: Variable expenses		
Power (90% of 600)	540	
Repairs & Maintenance (80% of 600)	480	(1,020)
Total fixed expenses during 2014-15		5,580
Less: Fixed expenses during strike period:		(1,440)
(16.09.2014 to 19.11.2014)		------
Fixed Expenses during Non-strike period		4,140

Since strike period was for 65 days (16.09.2014 to 19.11.2014), the non-strike period is 300days.

Hence fixed expenses attributed to 18 days i.e. 20.11.2014 to 07.12.2014 is 6% (18/300) of Rs. 4140 = Rs. 248.40 lakh

(Amount in Rs. Lakh)

Expenses (fixed) incurred during the period of 16.09.14 to 19.11.14	1,440.00
Expenses (fixed) incurred during the period of 20.11.14 to 07.12.14.	248.40
TOTAL	1,688.40

Hence, the amount to the tune of Rs.1,688.40 lakh is to be treated as abnormal cost andshould be excluded from the product cost.

CAS ILLUSTRATIONS

ILLUSTRATION 7:

A unit actually operated 291 days in a year and was stopped for abnormalcircumstances –

(i) 6 days due to power disruption for cyclone and flood, and

(ii) 4 days due to heavy breakdown of core machinery.

The rest of the days were weekly off or holidays. Half wages as lay-off compensation were paid for the stoppage period. During the year, total expenses incurred were

(A) Salaries and wages (including lay-off compensation of Rs. 65 lakh) Rs. 3,360 lakh, and

(B) Other fixed costs Rs. 1,050 lakh.

Find Abnormal Costs (in Rs. lakh).

ANSWER:

As per Cost Accounting Standard on Material Cost (CAS- 6), any abnormal cost shall be excluded from material cost. So cost of abnormal events such as strike, lock out and other factors are not included in cost. The abnormal cost is estimated as below.

	Total Fixed Costs	Abnormal Costs
Working days	291+6+4 = 301	6+4 = 10
Salaries and Wages (Rs. in lakh)	3,360	65
Other Fixed cost (Rs. in lakh)	1,050	= 1050 × (10/301) = 34.88
Total	4,410	99.88

Out of total fixed costs of Rs. 4,410 lakhs, abnormal costs of Rs. 99.88 lakhs will not form part of cost of production.

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CAS 2 ILLUSTRATIONS

ILLUSTRATION 1.

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

The Company's specifications capacity for a machine per hour	1,500 units
No. of shifts (each shift of 8 hours) per day	3 shifts
Paid Holidays in a year (365 days):	
(i) Sunday	52 days
(ii) Other holidays	12 days
Annual maintenance is done within these holidays	—
Preventive weekly maintenance for the machine is carried on during Sundays	
Normal idle capacity due to lunchtime, shift changes etc. per shift	1 hour
Production based on sales expectancy in past 5 years (units in Lakh):	**75.70**
	87.42
	65.38
	77.97
	76.08
Actual Production for the year (units in lakh)	81.50

You are required to calculate:

(i) Installed Capacity

(ii) Practical Capacity

(iii) Actual Capacity (%)

(iv) Normal Capacity

(v) Idle Capacity (%)

(vi) Abnormal Capacity

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

Raghav ACADEMY

Answer: **Calculation of different capacities Burnett Ltd**

(i) Installed Capacity: days in year x working hours per day x unit per hour
365 x 8 x 3 x 1500 = 131.40 lakh units

(ii) Practical capacity: days available × available hour per shift
× shifts × units per hour(365-52-12) x (8-
1) x 3 x 1500 = 94.815 lakh units

(iii) Actual capacity Utilization: Current production / Installed capacity
(81.50 / 131.40) x 100 = 62.02%

(iv) Normal capacity: (75.70+87.42+65.38+77.97+76.08) / 5 = 76.51 lakh units

(v) Idle Capacity: Installed capacity – Actual capacity
(131.40-81.50) = 49.90 / 131.40 = 0.3798 = 37.98%

(vi) Abnormal Idle capacity: (94.815 – 81.50) = 13.315 lakh units

Illustration 2.

The following information pertains to REACON CEMENT LTD., a manufacturing cement company for the year that ended as follows:

The year ended March 31.	2017-18	2016-17
Rated Capacity per Hr (in MT)	80	80
Break down (Hrs)	2,177	1,015
Planned Maintenance (Hrs)	247	422
Power restrictions (Hrs)	1,237	1,481
Shortfall (there are no orders) (Hrs)	792	677
Want of wagons (Hrs)	495	635
Total stoppage (Hrs)	4,948	4,230
Total running (Hrs)	3,888	4,582
Total available Hours	8,836	8,812
Production during the year (in MT)	2,48,844	3,29,928
Hourly Rate of Production (in MT)	64	72
Capacity Utilization (%)	62.21	82.48
Annual Installed Capacity (in MT)	4,00,000	4,00,000

Based on information stated above, you as a Cost Auditor are required to offer your comments on

(i) The performance of the company

Your suggestion for improvement.

ANSWER:

(a) Rated capacity = 80 MT/Hr : Rated capacity achieved in 2016-17 = (72/80) x100 = 90%

Rated capacity achieved in 2017-18 = (64 /80) × 100 = 80% The capacity achievement as % of rated capacityhas declined from 90% to 80% in 2017-18.

Further the Capacity Utilization has gone down to 62.21% in 2017-18 from 82.48% of previous year; a reduction of 20.27%

(b) From the data available the following observations are noted:-

1. Breakdown hours have gone up from 1,015 hours to 2,177 hrs, an increase by 114.48%
2. Planned Maintenance hrs has reduced from 422 hrs to 247 hrs i.e. by 41.47%
3. Shortfall hrs due to lack of orders has increased from 677 hrs to 792 hrs i.e. by 16.99%
4. The total stoppage hrs. has increased from 4,230 hrs to 4,948 hrs i.e. by 16.97%
5. The total running hrs has come down from 4,582 hrs to 3,888 hrs i.e. by 15.15%
6. The production has come down from 3,29,928 Mt to 2,48,844 Mt i.e. by 24.58%

From the above findings, it can be pointed out that the under utilization of capacity to the extent of little over 20% can be attributed mainly to:-

- Increased total stoppage hours of 4,948 of 2017-18 as against that of 4,230 hrs in 2016-17 and

The net increase of 718 hrs (4,948-4,230) is again due to increase of break down by 1,162 hrs (2,177- 1,015) in the year 2017-18.

Suggestion:

Therefore, the Company should look into the aspect of proper maintenance, securing sufficient orders to avoidlost time. Better utilization of capacity can be also be achieved by improving availability of wagons. The companymay also carry out a cost-benefit analysis to have captive source of power.

ILLUSTRATION 3.

The following data have been available of Sunflag Dolon Limited:

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

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

(i) Calculate the abnormal cost due to power cut.

(ii) How would you treat these abnormal cost?

CAS 2 ILLUSTRATIONS

ANSWER:

	2015-16	2016-17	2017-18
Installed Capacity – Ton	250	250	250
Production – Ton	240	230	125
% of Capacity Utilisation	96	92	50
Cost per Unit (Rs./Ton)	1,000	1,077	1,660
Escalation factor	100	105	107
Cost at base year price	1,000	$\left(1077 \times \frac{100}{105}\right)$ i.e. 1,026	$\left(1660 \times \frac{100}{107}\right)$ i.e. 1,551
Total cost of production	2,40,000	2,35,980	1,93,875
(Rs.)Variable Cost/Ton	402	402	401
(Rs.)	598	624	1,150
Fixed Cost/Ton	574		
Fixed Cost @ 100% utilisation(Rs.)			

Hence, increase in Fixed Cost/Ton due to poor capacity utilization in 2017-18

= (1,150−574) = Rs. 576

(i) Total abnormal cost due to power cut = 576 x 125 = Rs. 72,000

(ii) The abnormal cost must be excluded from computation of cost and has to be shown under Para 7 of the Cost Audit Report as "Abnormal Non-Recurring Cost".

(iii) The 50% under utilisation of capacity being due to power-cut only, the Company should consider possibility of captive generation, if the power-cut is likely to persist. Accordingly, the investment needed, potential savings, etc. must be computed to determine the viability of such a decision.

Working Notes:

	2016-17	2017-18
Difference in Total Cost	[2,40,000 – 2,35,980] = 4,020	**[2,35,980 – 1,93,875] = 42,105**
Difference in production	10	**105**
Hence Variable Cost	**402**	**401**

CAS 2 ILLUSTRATIONS

ILLUSTRATION 4.

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

The total capacity for 5 Machines per hour as per the company's specification.	**2500 Units**
No. of shifts (each shift of 8 hours) per day	**3**
Paid holidays in a year (365 days):	
(i) Weekly holidays	**52**
(ii) Other holidays	**10**
Annual maintenance is done within these holidays (i.e. 10)	
Preventive maintenance for the machines is carried on during weekly off day.	
Normal idle capacity due to lunchtime, shift changes etc. per shift	**0.5 hour**
Production based on sales expectancy in past 3 years (units in lakh):	**154.50**
	159.54
	166.66
Actual production for the year ended March 31, 2018:	**158.80**

You are required to calculate:

(1) Installed Capacity

(2) Practical Capacity

(3) Actual Capacity (%)

(4) Normal Capacity

(5) Idle Capacity (%)

(6) Abnormal Capacity—

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

ANSWER:

(1)	**Installed Capacity : 365 x 8 x 3 x 2500 = 21900000 i.e. 219 lakh units**
(2)	**Practical capacity: (365 – 52 -10)x (8-0.5)x3x2500= 17043750 i.e. 170.4375 lakh units**
(3)	**Actual capacity (given) = 158.80 lakhs units**
	Actual capacity utilization: (158.80/219) x 100 = 72.51%
(4)	**Normal Capacity: (154.50 + 159.54 + 166.66)/3= 160.23 lakh units**
(5)	**Idle capacity: (219 - 158.80) = 60.20, lakh unit i.e. (60.20/219) = 27.49%**
(6)	**Abnormal Idle capacity: (170.4375 – 158.80) = 11.6375 lakh units i.e. (11.6375/170.4375) =6.83%.**

CAS 2 ILLUSTRATIONS

ILLUSTRATION 5.

A plant operates 3 shifts of 8 hours each for all days except Sundays and 8 holidays.

Preventive maintenance is taken care in Sundays and annual maintenance in 8 hoildays.

Normal idle time for food, shift change and other work for the workers is 1 hour per shift. Installed Capacity of the machine = 1200 units per hour.

Production during last 5 years & Current year are 69.4, 72.6, 71.4, 70.5, 70.8, 69.9 lakh units

Determine according to CAS 2, Installed capacity, actual capacity, Idle capacity, abnormal idle capacity.

Answer:

(i) Installed capacity = days in year x working hours per day x unit per hour

= 365 x 8 x 3 x 1200 unit = 105.12 lakh units

(ii) Available capacity = days available × available hour per shift × shifts × units per hour

= (365 – 52 – 8) x (8 – 1) x 3 x 1200 = 76.86 lakh units

(iii) Normal capacity = 69.4 + 72.6 + 71.4 + 70.5 + 70.8/5 = 70.94 Lakhs units

(iv) Actual capacity = Current production / Installed capacity = 69.9 / 105.12 = 66.50 %

(v) Idle capacity = Installed capacity – Actual capacity = 105.12 – 69.90 = (35.22/105.12) × 100 = 33.50%

(vi) Abnormal Idle capacity = Normal capacity – Actual capacity

= 76.86 – 69.9 = 6.96 lakh units

Raghav ACADEMY

CAS 4 & 5 ILLUSTRATIONS

ILLUSTRATION 1.

A production process has three stages.

Stage	Input material cost	Processing cost	Total
(Rs. / MT)	(Rs. / MT)	(Rs. / MT)	
1	2000	500	2500
2	2500	1000	3500
3	3500	1000	4500

If during the production process at stage 3, the scrap is produced and the same is recycled at stage 2 after making an expenditure of Rs. 200 per MT to make it suitable for re-processing at stage 2, then scrap will bevalued @ Rs. (2500 – 200) i.e Rs. 2300. If no expenditure is involved to make scrap re-usable, the scrap value willbe @ Rs. 2500. The scrap value for the scrap produced during a period calculated at the rate as explainedabove may be deducted to find out the cost of production for the period.

ILLUSTRATION 2.

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

Particulars	Rs. '000
Direct Material Cost per unit	2,560
Direct Wages & Salaries	1,540
Direct Expenses	450
Indirect Materials	533
Factory Overheads	897
Administrative Overheads (40% relating to Production activities)	1,250
Quality Control Cost	565
Research and Development Cost	600
Interest on Working Capital	350
Sale of Scrap Realised	460

You are to determine the cost of production for the purpose of captive consumption in terms of the Rule 30 of the Central Goods & Services Tax Rules 2017 and as per the CAS-4 (Revised) and the Assessable Value for the purposeof paying GST on applicable transactions.

Answer:

According to the Rule 30 of the Central Goods & Services Tax Rules 2017, the assessable Value of goods usedfor captive consumption is 110% of cost of production of such goods. The manner of determination of cost ofproduction for captive consumption is laid down in CAS 4.

Particulars	Rs. in '000
Direct Material	2,560
Direct wages and salaries	1,540
Direct expenses	450
Indirect Materials	533
Factory Overheads	897
Administrative Overheads (40% on Rs.1,250)	500
Quality Control Cost	565
R& D Cost	600
Total cost	7,645
Less: realisation of scrap	460
Cost of production as per CAS 4	7,185

Note : 1. The cost of Working Capital Interest is not chargeable to Cost of Production

2. Assessable value as per Rule 30 of CGST Rules, 2017 is Rs. 79,03,500 (110 % × 71,85,000)

ILLUSTRATION 3.

ANGEL ELECTRONICS LTD. is engaged in the manufacture of LED TV sets having its factories at Patna and Gujarat.The company manufactures picture tube at Patna which is consumed to produce LED TV sets at Gujarat factory. The following information pertaining to captively consumed picture tubes are extracted from the records of the company for the half year ended March 31, 2018.

(Rs. IN 000)

Direct material	950
Direct wages and salaries	357
Direct expenses	80
Indirect materials	70
Factory overheads	320
Administrative overheads (20% relating to production activities)	640
Quality control cost	100
Research and development cost	125
Selling and distribution expenses	225
Sale of scrap realized	130
Profit margin	15%

CAS 4 & 5 ILLUSTRATIONS

You are required to determine:

(i) The cost of production for purpose of captive consumption in terms of Rule 30 of the Central Goods & ServicesTax Rules 2017 and as per CAS-4 (Revised), and

(ii) Also Assessable Value for the purpose of paying GST on applicable transactions.

ANSWER:

(Rs. IN 000)

Direct materials	**950**
Direct wages and salaries	**357**
Direct expenses	**80**
Factory overheads (320+70)	**390**
Quality control cost	**100**
Research and development cost	**125**
Administrative overheads (to the extent relates to Production activities)	**128**
Less: Sale of scrap realized	**(130)**
Cost of production	**2,000**
Add: 10% as per rule 30 of CGST Rules, 2017 (10% of Rs. 2,000)	**200**
Assessable Value as per rule 30 of CGST Rules, 2017	**2,200**

Raghav ACADEMY

CAS 5

{DECEMBER 2017}

QUESTION:
How to treat Inward Transportation Cost as per the Cost Accounting Standard 5? How Transportation Cost is to be determined in case the manufacturer is having its own transport fleet?

ANSWER:

As per the Cost Accounting Standard 5, Inward transportation cost is the transportation expenses incurred in connection with the materials/goods received at factory or place of use. Inward transportation costs shall form the part of the cost of procurement of materials which are to be identified for proper allocation/apportionment to the materials/ products.

In case of a manufacturer having his own transport fleet, proper records shall be maintained to determine the actual operating cost of vehicles, showing the details of various elements of cost, such as salaries and wages of driver, cleaners and others, cost of fuel, lubricant, grease, amortised cost of tyres and battery, repairs and maintenance, depreciation of vehicles, distance covered and trips made, goods hauled transported to the depot.

Separate records should be maintained as per Appendix 1 to the standard separately for

(i) Inward transportation

(ii) Outward transportation

(iii) Movement for home consumption and export

(iv) Separate for production and trading activities

(v) Separate for transportation other than by road, viz, by air, etc.

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CAS 6 ILLUSTRATIONS

ILLUSTRATION 1.

Purchase of Materials Rs. 3,00,000 (inclusive of GST of Rs. 15,715); Fee on Board Rs. 12,000; Import Duty paid Rs. 15,000; Freight inward Rs. 20,000; Insurance paid for import by sea Rs. 10,000; Rebates allowed Rs. 4,000; Cash discount Rs. 3,000; Subsidy received from the Government for importation of these materials Rs. 20,000. Compute the landed cost of material (i.e. value of receipt of material).

Answer:

(a) Computation of Material Cost Sheet

	Particulars	**Amount (Rs.)**
	Purchase price of Material	**3,00,000**
Add:	Fee on Board	**12,000**
Add:	Import Duties of purchasing the material	**15,000**
Add:	Freight Inward during the procurement of material	**20,000**
Add:	Insurance paid	**10,000**
	Total	**3,57,000**
Less:	Rebates	**4,000**
Less:	GST Input Tax Credit	**15,715**
Less:	Subsidy received from the Government for importation of materials	**20,000**
	Value of Receipt of Material	**3,17,285**

Note:

(i) Cash discount is not allowed, as it is a financial item.

(ii) Subsidy received, rebates and GST Input Tax Credit are to be deducted for the purpose of computing the material cost.

ILLUSTRATION 2.

Purchase of Materials $ 50,000 [Forward contract rate $ = Rs.64.40 but $ = Rs.64.60 on the date of importation] ; Import Duty paid Rs.5,65,000; Freight inward Rs.1,62,000 ; Insurance paid for import by road Rs.48,000; Cash discount Rs.33,000; Payment made to the foreign vendor after a month, on that date the rate of exchange was $ = Rs.65,20. Compute the landed cost of material.

Answer: **Computation of Landed Cost of Material**

	Particulars	**Amount (Rs.)**
	Purchase price of Material [50,000 x 64.60]	**32,30,000**
Add	Import duties of purchasing the material	**5,65,000**
Add	Any taxes paid during the purchase of material	**1,62,000**
Add	Freight Inward during the procurement of material	**48,000**
	Value of Receipt of Material	**40,05,000**

(i) Excess payment made to the vendor due to exchange fluctuation is not an includible cost, hence not considered.

(ii) Though the forward contract rate was $ = Rs.64.40, but the exchange rate on the date of importation is considered. Hence, included in the cost of materials. Accordingly, the purchase cost is computed consideringthe $ = Rs.64.60.

ILLUSTRATION 3.

Opening stock of raw materials (5,000 units) Rs. 1,80,000; Purchase of Raw Materials (17,500 units) Rs. 7,00,000; Closing Stock of Raw Materials 3,500 units; Freight Inward Rs. 85,000; Self-manufactured packing material for purchased raw materials only Rs.60,000 (including share of administrative overheads related to marketing sales Rs. 8,000); Demurrage charges levied by transporter for delay in collection Rs. 11,000; Normal Loss due to shrinkage 1% of materials ; AbnormalLoss due to absorption of moisture before receipt of materials 100 units. Calculate the value of Closing Stock.

Answer:

Computation of value of closing stock of raw materials [Average Cost Method]

	Particulars	**Quantity (Units)**	**Amount (Rs.)**
	Opening Stock of Raw Materials	5,000	**1,80,000**
Add	Purchase of raw materials	17,500	**7,00,000**
Add	Freight inwards		**85,000**
Add	Demurrage Charges levied by transporter for delay in collection		**11,000**
			9,76,000
Less	Abnormal Loss of raw materials (due to absorption of moisture beforereceipt of materials) = [(7,00,000 + 85,000 + 11000) x 100]/17,500	(100)	**(4,549)**
Less	Normal loss of materials due to shrinkage during transit [1% of 17,500 units]	(175)	-----
Add	Cost of self-manufactured packing materials for purchased raw materials only (60,000 – 8,000)		**52,000**
	Cost of raw materials	22,225	10,23,451
Less	Value of Closing Stock = Total Cost / (Total units – Units of Normal Loss) [10,23,451/(5,000+17,500 – 175)]x 3,500	(3,500)	**(1,60,451)**
	Cost of Raw Materials Consumed	18,725	8,63,000

CAS 6 ILLUSTRATIONS

Note:

(i) Units of normal loss adjusted in quantity only and not in cost, as it is an includible item

(ii) Cost of self-manufactured packing materials does not include any share of administrative overheads or finance cost or marketing overheads. Hence, marketing overheads excluded.

(iii) Abnormal loss of materials arose before the receipt of the raw materials, hence, valuation done on the basis of costs related to purchases only. Value of opening stock is not considered for arriving at the valuation of abnormal loss.

(iv) Demurrage charges paid to transporter is an includible item. Since this was paid to the transporter, hence considered before estimating the value of abnormal loss.

Raghav
ACADEMY

STUDY NOTE 8 MANAGEMENT REPORTING ISSUES UNDER COST AUDIT

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 individual market share 5% to 10%. Survey on the present market estimates that demand will increase of 80,000 units per year. The company is presently targeting 50% of the additional market demand as competitors will need at least two years to match its product.

The Product EZY passes through three departments. Direct cost per unit of product at present rate : Material cost: Rs. 65 and Labour Cost Rs. 45. Overheads are absorbed on the basis of normal capacity. The following relevant information is given :

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

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

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

Answer:

DP	Normal monthly capacity	Allocated monthly Fixed Overhead (Rs.)	Fixed Overheads per Hour (Rs.)	Full overhead cost per hour (Rs.)	Variable cost per hour (Rs.)	Fixed over head per unit (Rs.)	**Variable overhead per unit (Rs.)**
X	12,500	50,000	4.00	10.50	6.50	8.00	**13.00**
Y	15,000	60,000	4.00	9.00	5.00	6.00	**7.50**
Z	**25,000**	**75,000**	**3.00**	**6.00**	**3.00**	**9.00**	**9.00**

50% of the additional demand = 80,000 x 0.50 = 40,000 unit.

Cost of the product :

Direct Material	Rs. 65.00
Direct Labour	Rs. 45.00
Variable Factory Overheads	Rs. 29.50
Fixed Factory Overhead	Rs. 23.00
Selling& Distribution Overheads (Rs. 300,000 ÷40,000)	Rs. 7.50
Total cost	Rs. 170.00

Selling Price will be in the range of Rs. (170 x 1.3) and Rs. (170 x 1.4) i.e between Rs. 221 and Rs. 238.

Suggestion :

The company can go for lower price as it covers full cost and ensure good profit. Lower price will give better penetration in the market and keep competitors away for longer term to match technology and price.

ILLUSTRATION 2.

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

	Dept A	**Dept B**
Direct Material	Rs. 240	**Rs. 200**
Direct Labour rate/hrs	Rs. 120	**Rs. 100**
Direct Labour hrs	2 hrs	**3 hrs**
V OH per hour	Rs. 50	**Rs. 30**
Fixed per hour (based on 100% capacity)	Rs. 60	**Rs. 40**
Value of Machine on revalueation	**Rs. 40 Lakh**	**Rs. 28 lakh**

New Technology cost = Rs. 25 lakhs, working capital = Rs. 7 lakh

Target volume of production in the 1st year

2000 units @ 25% capacityVariable S & D cost is

Rs. 3 lakh for 2000 units.

Expected return on investment 24%.

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

Answer:

Rs.

	Dept A	Dept B	Total
Direct Material	240	200	**440**
Direct Labour	240	300	**540**
Variable Overheads	100	90	**190**
V. S & D cost			**150**
Total (Rs.)			**1320**

100% capacity = 8,000 units. 80% capacity = 6400 units

Fixed Costs = (60 x 16,000 + 40 x 24000) = Rs. 19.20 lakh

Capital investment = (40+

28+25+7) = Rs. 100 lakhReturn

on investment required = Rs.

24 lakh

Return required per unit = Rs. (lakh 19.2 + 24.0) /6400 = Rs. 675

Price to be charged per unit = (1320 + 675) = Rs. 1995

ILLUSTRATION 3.

A company is operating at 60% capacity with a turnover Rs. 86.40 lakhs.

(i) If the Company works at 100% capacity, the sales-cost relation is: Factory Cost istwo-third of sales value andPrime Cost is 75% of Factory Cost.

(iii) Administrative and selling expenses (75% variable) is 20 % of sales value.

(iv) Factory overhead will vary according to operating capacity as given below :

Operating Capacity	60%	80%	100%	**120%**
Factory overhead (Rs. Lakhs)	**19.80**	**21.60**	**24.0**	**30.00**

The company has planned to operate at 80% capacity. Moreover, it has received an export orderand the execution of the same will involve 40 % of capacity. The prime cost of the order is estimated as Rs. 12.00 lakhs and shipping expenses involved will be Rs. 2.00 lakhs. Taking same percentage of profit on domestic sale, determine minimum price to be quoted for the export order.

Answer:

At 100% capacity.

Sale = 86.40 x 100/60	=	Rs. 144 lakhs
Factory Cost =1.44 x 2/3	=	Rs. 96 lakhs
Prime Cost = 96 x .75	=	Rs. 72 lakhs
Factory overheads	=	Rs. 24 lakhs
Selling & Distribution Exp	=	Rs. 28.8 lakhs
Variable S/D Exp	=	Rs. 21.6 lakhs
Fixed S/D Exp	=	Rs. 7.2 lakhs

	Operation 80% capacity(Rs. **Lakhs)**	**Export order 40% capacity(Rs. lakhs)**
Prime Cost	57.60	**12.00**
Factory overhead (given)	21.60	**8.40**
Selling & Dist. Cost-variable	17.28	**-**
Selling & Dist. Cost – fixed	7.20	**2.00**
Total Cost of Sales	103.68	**22.40**
Sales Value(at 80% capacity)144 x 0.80	115.20	
Profit	11.52	**2.49**
Profit %	10% on sales	**10% of export sales value**
Export Price to be quoted		**24.89**

Let, Sales value = x,

then profit = 0.1x

Then 0.9 x = 22.40

Hence x = 24.89

ILLUSTRATION 4.

ABC Co. has planned for an investment of Rs. 800.00 lakh with 50% Loan from Banks at 10% interest.

Direct Cost for the year = Rs. 480.0 lakhs and 50% of which is Material cost. Other expenses are at

Rs. 80.0 lakh. The goods will be sold at 150% of direct cost. Tax rate is assumed at 50%.

Determine (i) Net profit margin (ii) Return on Assets (iii) Assets turnover (iv) Return on owners equity (v) Inventory Turnover Ratio.

Answer:

	Rs. lakh
Sales : 480 x 1.5	720
Direct Cost	480
Gross Profit	240
Operating Exp + interest	120
Profit before Tax	120
Net profit after Tax	60
(i) Net Profit Margin (60/720)	8.33%
(ii) Return on Assets (60/800)	7.5 %
(iii) Return on Equity (60/400)	15%
(iv) Asset Turnover (720/800)	0.9
(v) Inventory Turnover (240/720) ×100	33.33%

ILLUSTRATION 5.

Z Electronics Co (ZEC) has made an agreement with Tuzuki of Japan for import of kits of Automatic WashingMachine in completely knocked down (CKD) condition. The terms of agreement are :

(i) Tuzuki will supply some items keeping 20% margin on cost. These imported items are of value of 40% of FOBprice of Washing Machine and balance 60% will be locally manufactured.

(ii) ZEC will pay a lump sum of Rs. 300 lakhs for technical know how and drawing for manufacturing of 3 lakhs
washing machines.

(iii) ZEC will also pay a royalty at 10% of selling price fixed by it in the local market less landed cost of importedkits and cost of locally procured components.

The following related information is also available :

(i) FOB price for washing machine is Rs. 8,000.

(ii) Insurance & freight is Rs. 300 per set of imported items

(iii) Effective custom duty is @ 40% on CIF price

(iv) Assembling & other overhead costs will be Rs. 1,000 per set.

(v) Expected profit is 20% on selling price

You are required to calculate the selling price of Washing machine (rounded to Rs. 10).

Answer:

	(Rs.)
FOB price of complete Washing Machine	**8,000**
Value of imported items (40% of FOB price)	**3,200**
Value of locally manufactured items (60% of FOB Price)	**4,800**
A. Cost of imported Items :	
(i) FOB price of imported parts	**3,200**
(ii) Freight & Insurance	**300**
(iii) CIF value	**3,500**
(iv) Custom duty 40% on CIF value	**1,400**
Landed cost of imported kits (iii) +(iv)	**4,900**
B. Cost of material - both imported + local (4800 +4900)	**9,700**
C. Assembling cost	**1,000**
D. Technical know how cost per machine	**100**
E. Total cost excluding royalty (B+ C + D)	**10,800**
F. Royalty	**434**
G. Total Cost	**11,234**
H. Profit (25% of Cost)	**2,806**
Selling Price of Washing Machine (G + H)	**14,040**

Working note for calculation of royalty :

Let Royalty = X

Cost = (10,800 + X)

Selling price = (10,800 + X) x 1.25 = (13,500 +1.25 X)

Royalty = (Selling Price – landed cost of imported kits - landed cost of local items) x

0.10 Or X = (13,500 + 1.25 X – 9,700) x 0.10

Or X = 380 + 0.125 X

Or 0.875 X = 380

Or X = 434

STUDY NOTE 8 MANAGEMENT REPORTING ISSUES UNDER COST AUDIT

ILLUSTRATION 1.

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

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

Cost Records provide as under :

(i) Factory Overheads is absorbed at 60% of direct wages

(ii) Administrative Overheads are recovered at 20% of factory cost.

(iii) Selling & Distribution overheads are charged at Rs. 4 per unit sold

(iv) Opening stock of finished goods is valued at Rs. 104 per unit.

(v) WIP is valued at factory cost both for Financial and Costing Profit Loss A/C.

Required :

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

(ii) Prepare a Reconciliation Statement for Profits under above two different records.

Answer:

Statement of Profit & Loss Accounts as per Financial records as on 31st March 2018:

	Rs.		Rs.
To Opening Stock of Fin goods	74,375	By Sales	**20,80,000**
To WIP	32,000	By Closing Stock of Fin Goods	**41,250**
To Raw Materials consumed	7,80,000	By WIP	**38,667**
To Direct labour	4,50,000	By Rent received	**18,000**
To Factory Overheads	3,00,000	By Interest received	**45,000**
To administrative Overheads	2,95,000		
To selling & Distribution Overheads	61,000		
To Dividend paid	85,000		
To Bad Debt	12,000		
To Profit	1,33,542		
	22,22,917		**22,22,917**

Working Notes for Cost Accounting :

Sales unit	**14,500**
Add closing stock	**375**
Less Opening Stock	**875**
Unit Produced	**14,000**
	Rs.
Raw materials	**7,80,000**
Direct Labour	**4,50,000**
Prime cost	**12,30,000**
Factory Overheads – 60% of direct wages	**2,70,000**
Factory Cost	**15,00,000**
Add Opening WIP	**32,000**
Less Closing WIP	**38,667**
Factory cost of Goods produced	**14,93,333**
Administrative Overheads 20% of factory cost	**2,98,667**
Cost of Production of 14,000 unts	**17,92,000**
Cost of Production per unit 17,92,000/14,000	**128**

STUDY NOTE 8 MANAGEMENT REPORTING ISSUES UNDER COST AUDIT

Profit as per Cost Accounting Records

	Rs.
Sales Revenue – 14,500 units	20,80,000
Cost of sales	
Opening Stock 875 units @ Rs. 104	91,000
Add : cost of Production	17,92,000
Less Closing stock – 375 x 128	48,000
Cost of Goods produced	18,35,000
Selling & Distribution Overheads : 14,500 x Rs. 4	58,000
Cost of Sales	18,93,000
Profit	1,87,000

Reconciliation statement

Profit as per Cost Accounts	1,87,000
Add:	
Admin overhead overabsorbed (2,98,667 -2,95,000)	3,667
Opening Stock overvalued (91,000 -74,375)	16,225
Interest received	45,000
Rent received	18,000
	2,70,292
Less:	
Factory Overheads under-recovery (3,00,000 -2,70,000)	30,000
Selling & Distribution Overheads under recovery (61,000-58,000)	3,000
Closing Stock overvalued (48,000-41,250)	6,750
Dividend	85,000
Bad Debt	12,000
Profit as per Financial Accounts	1,33,542

STUDY NOTE 8 MANAGEMENT REPORTING ISSUES UNDER COST AUDIT

ILLUSTRATION 2.

In normal cases, high operating cost appears due to high wage cost. The Operating assets of the firm, both currentand fixed stands at higher level.

Profit and Loss Account and Balance sheet for the year ending 31.03.2018 are given below:

Balance Sheet

	Rs. lakh		Rs. Lakh
Equity	8.00	Land & Building	**2.85**
7@ Pref Share	2.00	Plant & Machinery	**5.60**
Reserve & Surplus	3.25	Furniture & Fixture	**0.67**
Unsecured Loan	2.40	Investment at cost	**1.00**
Sundry Creditors	4.35	Inventory	**5.40**
Outstanding expenses	0.46	Sundry Debtors	**5.14**
Provision for taxation	0.80	Bills Receivables	**0.60**
Proposed Dividend	1.10	Cash in Bank & Hand	**1.09**
Total Liabilities	**22.36**	**Total Assets**	**22.36**

Profit & Loss Account

To Opening Stock	1.50	By Sales	**41.50**
To Purchase	12.75	By Closing Stock	**1.75**
To Direct wages	6.00		
To Factory Expenses	12.95		
To Gross profit	10.05		
	43,25		**43.25**
To Selling & Dist. Expenses	5.20	By Gross Profit	**10.05**
To Administrative Expenses	2,80	By other income	**0.25**
To Net Profit	2.30		
	10.30		**10.30**
To Provision for taxation	0.80	By Net Profit	**2.30**
To Proposed dividend	1.40		
To General Reserve	0.40		
	2.30		**2.30**

As a Cost Auditor, determine i) Capital Employed ii) Net Worth iii) Profit before Tax and calculate the necessary ratio.

Answer:

(i) Fixed Asset = 2.85 + 5.60 + 0.67 = Rs. 9.22 lakh

(ii) Current Asset = 5.40 + 5.14 + 0.60 + 1.09 = Rs. 12.23 lakh

(iii) Total Asset = Fixed Asset + Current asset = 9.22 + 12.24 = Rs. 21.45 lakh

(iv) Current Liabilities = 4.35+ 0.46+ 0.80 + 1.10 = Rs. 6.71 lakh

(v) Capital employed = Total asset – Current liabilities =

21.45– 6.71 = Rs. 14.74 lakh

(vi) Net worth = 8.00 + 2.00 + 3.25 = Rs. 13.25 lakh

(vii) Profit before Tax = Rs. 2.30 + 0.45 – 0.25 = Rs. 2.50 lakh

Ratios :

(i) Profit on Capital employed = Rs. 2.50 /14.65=17.04%

(ii) Profit to sales = 2.50 /41.50 = 6.02%

(iii) Current assets / Current Liabilities = 12.23 / 6.71 = 182%

(iv) Net worth to Long term borrowings = 13.25 /2.40 = 552%

(v) Net Worth to Capital Employed = 13.25 /14.74 = 89.89%

(vi) Cost of Production to Capital Employed = 34.25 /14.74 = 232.36%

(vii) Cost of Production to Working Capital = 34.25 /(12.23–6.71) = 620%

Calculation of Cost of Production :

Purchase :	12.75
Stock Adjustment	- 0.25
Direct Wages	6.00
Factory Cost	12.95
Admin OH	2.80
	34.25

STUDY NOTE 8 MANAGEMENT REPORTING ISSUES UNDER COST AUDIT

ILLUSTRATION 3.

The following figures for a period 2017-18 for a company :

	Rs. Lakh
Sales	248.00
Purchase of raw material	100.00
Agent Commission	2.00
Consumable stores	2.50
Packing Materials	1.00
Stationery	1.00
Audit Fees	0.40
Staff Welfare Expenses	15.80
Insurance	2.60
Rent, Rates & Taxes	1.60
Managing Directors Remuneration	8.40
Travelling Exp	2.10
Fuel & Oil	0.90
Electricity	0.50
Material used in Repair : Plant & Machinery	2.40
To Building	1.00
Advertisement	2.50
Salaries & Wages	63.0
Postage & Telegram ostage	1.40
Contribution to PF	6.00
Director's sitting fees & Travelling expenses	4.00
Subscription paid	0.20
Carriage	2.20
Interest on Loans Loans	1.80
Dividend to shareholders	3.00
Depreciation provided	5.50
Income Tax provided	10.00
Retained earning	12.50
Opening Stock : Raw Material	8.50
Finished Goods	20.00
Closing Stock : Raw Material	10.80
Finished Goods	24.00

From the above, prepare a statement of Value Addition and disposal of the same.

STUDY NOTE 8 MANAGEMENT REPORTING ISSUES UNDER COST AUDIT

Answer:

Statement of Value Addition & Disposal of it

	Rs. Lakh	**Rs. Lakh**
Sales	248.00	
Less Agent's commission	2.00	
Add Change in finished Goods	4.00	**250.00**
Less in Bought in Materials & Services		
Raw Materials Purchase	100.00	
Less change in stock	2.30	
	97.70	
Other Materials		
Consumables	2.50	
Packing	1.00	
Stationery	1.00	
Fuel & Oil	0.90	
Electricity	0.50	
Repair to Plant	2.40	
Repair to Building	1.00	
	9.30	
Services		
Audit fees	0.40	
Insurance	2.60	
Rent & Rates	1.60	
Travelling Expenses	2.10	
Advertisement	2.50	
Postage	1.40	
Subscription	0.20	
Carriage	2.20	
	13.00	**-120.00**
Value Addition		**130.00**
Disposal of Value Addition		
To Employees		
Managing Director	8.40	
Director's sitting fees etc	4.00	
Salares& Wages	63.00	
Contribution to PF	6.00	
Staff Welfare	15.80	**97.20**
To Government : Tax		**10.00**
To Providers of capital		
Interest on Loan	1.80	
Dividend	3.00	**4.80**
To Reinvestment of Business		

Depreciation	5.50	
Retained earnings	12.50	**18.00**
Total		**130.00**

ILLUSTRATION 4.

From the following balance sheet and other data of PQR Ltd. make out the ratio analysis of specific items asrequired below :

(a) Profit as a percentage of

(i) Capital employed

(ii) Net sales

(b) Current assets expressed a percentage of current liabilities (including provisions)

(d) Net worth expressed as a percentage of capital employed.

You may assume fixed assets, etc. at average values as indicated below. Working must form part of your answer:

I.	**Sources of funds :**	Rs.	**Rs.**
	1. Shareholders' funds		
	(a) Share capital	7,20,000	
	(b) Reserve and surplus	18,90,000	**26,10,000**
	2. Loans funds		
	(a) Secured loan	13,65,000	
	(b) Unsecured loan	34,000	**13,99,000**
			40,09,000

II. **Application of funds :**

1.	Fixed assets —	Rs.	**Rs.**
	(a) Gross block	16,81,000	
	(b) *Less:* Depreciation	9,74,000	
	(c) Net block	7,07,000	
	(d) Capital work in progress	22,000	**7,29,000**
2.	Investments (outside the business)		**27,500**
3.	Current assets, loans & advances		
	(a) Inventories	29,29,000	
	(b) Sundry debtors	35,85,000	
	(c) Cash and bank balances	8,85,000	
	(d) Other current assets	**1,100**	

(c) Loans and advances		4,46,000	
Total	(A)	78,46,100	
Less: Current liabilities & provisions			
(a) Liabilities		43,96,000	
(b) Provisions		2,40,000	
Total	(B)	46,36,000	
Net current assets (A – B)			32,10,100

4	Miscellaneous expenditure to		
	the extent nor written off or adjusted		42,400
	Other datas :		40,09,000
	Profit after interest (before taxation)	4,91,000	
	Interest	2,58,000	
	Sales	1,23,98,000	

Answer:

(i)	Profit before tax and interest	(Rs. in Lakhs)
	(a) Profii before tax	4.91
	Add: Interest	2.58
	Profit prior to interest	7.49
(ii)	Capital employed Fixed assets at net book value	
	(excluding capital W!P)	7.070
	Add : Current assets minus current liabilities	32.101
		39.171
(iii)	Net worth	
	Share capital plus reserves & surplus	26.100
	Less: Miscellaneous expenditure	0.424
		25.676

(a) (i) $\frac{\text{Profit}}{\text{Capital employed}}$ $\frac{7.49}{39.171} \times 100 = 100 = 19.12\%$

(ii) $\frac{\text{Profit}}{\text{Net Sales}}$ $\frac{7.49}{123.98} \times 100 = 100 = 6.04\%$

(b) $\frac{\text{Current assets}}{\text{Current liabilities}}$ $\frac{78.461}{46.360} \times 100 = 100 = 169.24\%$

(c) $\frac{\text{Net worth}}{\text{Long term borrowing \& liabilities}}$ $\frac{25.676}{13.990} \times 100 = 100 = 183.5\%$

(d) $\frac{\text{Net worth}}{\text{Capital employed}}$ $\frac{25.676}{39.171} \times 100 = 100 = 65.55\%$

Workings :

			Rs. lakhs
(i)	**Current assets —**		**78.461**
	Current liabilities and provision		**46.360**
	Net current assets		**32.101**
(ii)	**Capital employed —**		**39.171**
	Financed by —		**26.100**
	Share capital & reserves		
	Loans		**13.990**
			40.090
	***Less:* Miscellaneous Expenditure**	0.424	
	Investments	0.275	
	Capital W.I. P.	0.220	**0.919**
			39.171

ILLUSTRATION 5.

Liabilities		(Rs. in lakhs)	Assets		**(Rs. in lakhs)**
Share Capital		2,800	Gross Block	28,900	
Reserves & Surplus :			Less : Depreciation	7,800	**21,100**
General Reserve	6,250		Capital Work-in-progress		
Share Premium	9,050		Investments		**2,200**
Revaluation Reserve	3,400	18,700	Current assets. Loans & Advances :		
Secured Loan:			Inventories	6,600	
Term Loan	8,600		Sundry Debtors	3,200	
Cash Credit	3,000	11,600	Cash & Bank Balances	620	
Current Liabilities & Provisions	9,500		Advances to suppliers of Equipment 1,200		
			Other Advances	4,400	**16,020**
			Miscellaneous Expensescarried forward		**2,530**
		42,600			**42,600**

The profit after interest provision of Rs. 650 lakhs for the same period was Rs. 1,765 lakhs. Compute the following figures/ ratios (for the company as a whole)

(a) Capital employed:
(b) Net worth;
(c) Net worth as percentage of long-term borrowings and liabilities;
(d) Profit as a percentage of capital employed.

You may assume figures for fixed assets and working capital at average values.

Answer:

(a)	*Capital Employed :*		**(Rs. in lakhs)**
	Net Block		**21,100**
	Net working capital:Current assets	16,020	
	***Less:* Current liabilities**	9,500	
	Net working capital		**6,250**
	Total Capital employed		**27,620**
(b)	*Net worth :*		
	Share capital		**2,800**
	General reserves		**6,250**
	Share premium		**9,050**
			18,100
Less:	Miscellaneous expenses to be written off		**2,530**
	Net worth		**15,570**
(c)	*Net worth as a percentage of long-term borrowings and liabilities :*		**15,570**
	(i) Net worth		
	(ii) Long-term borrowings		**11,600**
	(i) as a percentage of (ii) = (15,570 ÷ 11,600) × 100 =		**134%**
(d)	*Profit as a percentage of capital employed :*		
	Profit after interest		**1,765**
	Interest		**650**
	Profit before interest		**2,415**
	Profit as a percentage of capital employed		**8.74%**

(2,415 +27,620) × 100

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

ILLUSTRATION 1.

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

(Rupees in Lakhs)

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

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

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

Required:

(i) **Calculate for the year 2017-18:**

A. **Return on Capital Employed.**

B. **Stock Turnover Ratio.**

C. **Return on Net Worth.**

D. **Current Ratio.**

E. **Proprietary Ratio**

Raghav ACADEMY

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

SOLUTION:

(A) **Computation of Capital Employed –**

	2018	2017
Fixed Assets	2,400	1,800
Less: Depreciation	840	600
	1,560	1,200
Current Assets		
Stock	720	600
Debtors	420	300
Cash & Bank	120	120
Other current assets	150	150
	1,410	1,170
Current Liability	774	150

Working capital	636	1,020
Net Fixed Assets + Working Capital	2,196	2,220

Average Capital Employed = (2,196 + 2,220)/2 = 2,208

Total Earning = Profit after tax + Interest on debt funds + Non-Operating Adjustments

= (900 – 144 – 360) + 144

= 540

Return on capital employed = Total Earnings divided by Average Capital Employed

= 540 / 2208 = 24.46%

Notes to the Computation of Capital Employed

1. Current Assets includes Stock, Debtors,Cash and Other Current Assets
2. Assumed that the Investments in Balance sheet are Non-Current Investments

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

3. Refer Financial Statements of 2016-17 for the ' Info. Not Available'

It is normally expressed as a percentage. It indicates the rate of return earned by an enterprise from its total Capital Employed in the business. It is also an indicator of the profit earning capacity of an enterprise. A higher return reveals a better profitability on the total Capital Employed in the business.

(B) Computation of Stock Turnover Ratio = Net Sales / Average Stock
= 3,600 (720 + 600)/2 = 5.45 times

This ratio indicates the movement of stock during a particular period. In other words, it indicates how fast goods are sold out from the stock of those goods. Higher ratio indicates a faster movement of stock.

(C) Return on Net Worth = Total Earning / Average Net Worth

In this formula, The word 'Average' is to be deleted because of the following.
As per Section 2(57) of Companies Act 2013, "Net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

Net Worth = Share Capital + Reserve & Surplus – Revaluation reserve – Accumulated losses, if any
Net Worth = 1,500 + 696 - 360 = 1,836

Return on Net Worth = 540 / 1,836 = 29.41%

It is normally expressed as a percentage. It indicates the rate of return earned by an enterprise on the capital invested by its owners. This is an indicator of the rate of return on the shareholders' fund invested in the business. A higher return reveals the better profitability to the shareholders' of the enterprise.

(D) Current Ratio = Current Assets / Current Liabilities

Current Ratio = 1,410 / 744 = 1.82
This ratio indicates whether an enterprise possesses sufficient Current Assets to pay off its Current Liabilities. This ratio is an indicator of short term solvency or liquidity position of an enterprise. Ideal ratio is 2:1, i.e., the enterprise should have twice the current assets than the current liabilities, to exhibit ideal short term solvency

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

(E) Proprietary Ratio = Proprietary Funds / Total Assets
Proprietary Ratio = Equity Share Capital + Preference Share Capital + reserve & Surplus – Accumulated Losses

= 1,500 + 696 – 360 = 1,836

Total Assets = Net Fixed assets + Total Current Assets (Only tangible assets will be included)
= 1,560 + 1,410 = 2,970
Proprietary Ratio = 1,836 / 2970 x 100 = 61.82 %

This ratio indicates the portion of Proprietors' Fund or Shareholders' fund invested in Fixed Assets. It is also an indicator of the efficiency of the management regarding the formulation of the financial planning.

ILLUSTRATION 2.

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

(i) Value Added.

(ii) Ratio of Operating Profit to Sales.

(iii) Ratio of Operating Profit to Value Added.

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

Selling and distribution expenses:	
Salaries and wages	240
Administration overheads:	
Salaries and wages	240

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

SOLUTION :

(i)	Computation of Value Added	Rs. in lakhs	Rs. in lakhs
	Net Sales+ Increase in Stock of Finished Goods		42,500
	Less:		
	Cost of bought out materials and services:		
	Raw Materials –	8,600	
	Packing Materials	2,560	
	Stores and Spares	1,120	
	Power and fuel	9,200	
	Insurance	240	
	Other factory overhead	500	22,220
	Value Added		20,280
	Composition of Value Added:		
	Depreciation (Company as retained funds)	1,770	
	Interest	2,796	
	Salaries and wages (960 + 480 + 240 + 240)	1,920	6,486
	Profit before tax (balancing figure) (Company as retained funds)		13,794
	Operating Profit : (Company as retained funds)		
	PBT		13,794
	Interest paid		2,796
			16,590

(ii) Ratio of operating profit to net sales = Operating Profit / Net Sales = 16,590 / 42,000 ×100 = 39.50%

(iii Ratio of operating profit to value added = Operating Profit / Value Added = 16,590 / 20,280 ×100 = 81.80%

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STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

ILLUSTRATION 3.

M LTD HAS THE FOLLOWING BALANCE SHEETS AS ON 31 MARCH 2018 AND 31 MARCH 2017:

PARTICULARS	Rs. in lakhs	
	31 March 2018	31 March 2017
Sources of Funds:		
Shareholder's Fund	4,954	3,144
Loan Funds	7,340	6,366
	12,294	9,510
Applications of Funds:		
Fixed Assets	7,132	6,000
Cash & Bank	1,178	1,140
Debtors	3,190	2,536
Stock	5,934	5,014
Other Current Assets	3,334	3,008
Less: Current Liabilities	(8,074)	(7,788)
	12,694	9,910

THE INCOME STATEMENT OF THE M LTD FOR THE YEAR THAT ENDED IS AS FOLLOWS:

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

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

Required:

(i) **Calculate for the year 2017-18**

a. **Inventory Turnover Ratio**

b. **Return on Net worth**

c. **ROI**

d. **ROE**

e. **Profitability ratio**

(ii) **Give a brief comment on the financial position of M Ltd.**

SOLUTION:

(i) a. Inventory Turnover Ratio (for the year 2017-18) = Cost of Goods Sold / Average Inventory = 4190 / 5,474 = 7.66

b. Return on Net Worth (for the year 2017-18) = Profit after tax / Net worth = 268 / 4954 x 100 = 5.41%

c. ROI (for the year 2017-18) = Net Profit before Interest but after tax / Average Capital Employed x100 = 494 / 11,302 x100 = 4.37%

Net Profit before interest but after tax = 268 + 226 = 494

Average Capital Employed = Average of Opening and closing of Net Current Assets + Average of Opening and closing of Net Current Assets
= (12,694+ 9,910)/2 = 11,302

d. ROE (for the year 2017-18) = Net Profit available to Equity Shareholders x100 Average Equity Shareholders' Fund
= 268 (4,954 + 3,144)/ 2 x100 = 6.62%

e. Profitability ratio (for the year 2017-18) –
(i) Gross Profit Ratio = Gross Profit / Sales x 100
2,610 / 44,530 x 100 = 5.86%

(ii) Operating Profit Ratio = Operating Profit / Sales x 100
314 + 226 / 44,530 x100 =1.21%

(iii) Net Profit Ratio = Profit before tax / Sales
314 / 44,530 x100 = 0.71% .

(ii) Profitability of operation of the company remarkably decline from Rs.1,372 (Rs.in Lakhs) to Rs.540 (Rs. in Lakhs), due to a huge increase in the operating expenses during the year 2017-18. NP of the company also reduces due to an increase in the interest expenses. During the year 2017-18, both Fixed operating expenses as well as fixed financial expense have increased, as a consequence of which the NP

of the company radically reduced. During 2017-18, both operating and Financial Leverages have become adverse, as a result of which the company has been crucially suffering from a liquidity crisis during the year 2017-18.

ILLUSTRATION 4.

Following are the summarized accounts of Key Ltd and Pee Ltd for the 2 years 2017 and 2018:

Particulars	Rs. in Lakhs			
	Key Ltd		Pee Ltd	
	2017	2018	2017	2018
Sales	5,412	4,575	1,752	1,447
Manufacturing & Other Expenses	5,104	4,356	1,496	1,182
Depreciation	56	51	60	35
Profit before Tax	252	168	196	230
	5,412	4,575	1,752	1,447
Miscellaneous Expenditure	165	169	-	-
Fixed Assets	836	941	351	275
Stock	1,124	1,219	177	226
Debtors	728	824	582	402
Bank	93	33	464	246
	2,946	3,186	1,574	1,149
Creditors	947	926	233	175
Taxation [Less Advance Tax]	56	68	87	58
Short-term Borrowings	424	800	464	216
Long-term Borrowings	254	210	10	-
Capital & Reserves	1,265	1,182	780	700
	2,946	3,186	1,574	1,149

You are required to:

(i) Indicate and calculate five Ratios which in your opinion are relevant in determining the stability of the two companies.

(ii) Compare the Ratios so determined for the two companies. Indicate what conclusions can be drawn therefrom?

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

SOLUTION:

In our opinion, the following five Ratios are very much relevant in determining the stability of the given two companies as growing concerns:

Computation of five Relevant Ratios in determining the stability of two companies

	Key Ltd		Pee Ltd	
	2017	2018	2017	2018
(i) Current Ratio CAs CLs	1,945 ÷ 1,427 = 1.36	2,076 ÷ 1,794 = 1.16	1,223 ÷ 784 = 1.56	874 ÷ 449 = 1.95
(ii) Total Debts to Net Worth	1,681 ÷ 1,100 = 1.528	2,004 ÷ 1,013 = 1.978	794 ÷ 780 = 1.017	449 ÷ 700 = 0.641
(iii) Total Asset Turnover	5,412 2,781 = 1.946	4,575 ÷ 3,017 = 1.516	1,752 ÷ 1,574 = 1.113	1,449 ÷ 1,149 = 1.259
(iv) ROI	252 ÷ 2,781 = 0.090	168 ÷ 3,017 = 0.055	196 ÷ 1,574 = 0.124	230 ÷ 1,149 = 0.20
(v) Liquid Assets to Operating Expenses [excluding Depreciation] per day	821 ÷ 13.98 = 59	857 ÷ 11.90 = 72	1,046 ÷ 4.09 = 256	648 ÷ 3.23 = 201

From the different Ratios as calculated in (i) above, it has been observed that the results of Pee Ltd for the year 2018 were better than that of Key Ltd. for 2017. On the other hand, the results of Key Ltd. for the year 2018 were weaker than that of for 2017. Short-term liquidity of solvency Ratios (i.e., Current Ratio and Liquid Assets to Operating-expenses Ratio) of Pee Ltd were improved in 2018 than 2017, whereas these Ratios of Key Ltd were deteriorated in 2018 than it was in 2017. Pee Ltd had improved its long-term solvency Ratios (i.e., Total debts to Net Worth and Total Asset Turnover Ratio) in 2018 than in 2017, whereas these Ratios were also deteriorated in 2018 than in 2017 in the case of Key Ltd. As far as profitability was concerned, Pee Ltd had remarkably increased its ROI in 2018 than it was in 2017, whereas ROI of Key Ltd was remarkably declined in 2018 than 2017.

Therefore, Ratios as computed in the above as showing as stronger position in 2018 as compared to 2017 in the case of Pee Ltd, whereas they are showing deterioration position in 2018 as compared to 2017 in the case of Key Ltd.

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

WORKING NOTES:

Rs. In Lakhs

1. Net Worth	Key Ltd		Pee Ltd	
	2017	2018	2017	2018
Capital & Reserves	1265	1182	780000	700000
Less : Miscellaneous Expenditure	165	169		
Net Worth	1100	1013	780	700

2. Total Outside Liabilities	Key Ltd		Pee Ltd	
	2017	2018	2017	2018
Long-term Borrowings	254	210	10	-
Short-term Borrowings	424	800	464	216
Creditors	947	926	233	175
Taxation [Less: Advance Tax]	56	68	87	58
Total Outside Liabilities	1681	2004	794	449

3. Current Assets	Key Ltd		Pee Ltd	
	2017	2018	2017	2018
Stock	1124	1219	177	226
Debtors	728	825	582	402
Bank	93	33	464	246
Current Assets	1945	2076	1223	874

4. Current Liabilities	Key Ltd		Pee Ltd	
	2017	2018	2017	2018
Creditors	947	926	233	175
Taxation [Less: Advance Tax]	56	68	87	58
Short-term Borrowings	424	800	464	216
Current Liabilities	1427	1994	784	449

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

5. Total Assets	Key Ltd		Pee Ltd	
	2017	2018	2017	2018
Fixed Assets	836	941	351	275
Current Assets [as computed in (3) above]	1945	2076	1223	874
Total Assets	2781	3017	1574	1149

6. Liquid Assets	Key Ltd		Pee Ltd	
	2017	2018	2017	2018
Current Assets [as computed in (3) above]	1945	2076	1223	874
Less: Stock	1124	1219	177	226
Liquid Assets	821	857	1046	648

7. Operating Expenses (excluding Depreciation) per day	Key Ltd		Pee Ltd	
	2017	2018	2017	2018
	5104/365	4356/366	1496/365	1182/365
	=13.98	= 11.90	= 4.09	= 3.23

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STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

ILLUSTRATION 5.

The Balance Sheets of SLtd for the last 3 years read as follows:

Rs. in lakhs

	As on 31March 2016	As on 31March 2017	As on 31March 2018
Sources of Fund:			
Share Capital [Share of Rs.10 each]	2,200	2,200	3,200
Securities Premium	1,900	2,000	700
Reserves [After 10% Dividend]	1,900	2,100	1,900
Long-term Loan	1,750	1,550	2,600
Total Funds	7,750	7,850	8,400
Represented by:			
Fixed Assets	2,800	3,200	3,500
Less: Depreciation	800	1,050	1,300
	2,000	2,150	2,200
Capital WIP [work-in-progress]	1,000	1,100	1,200
Investment	600	700	650
A.	3,600	3,950	4,050
Net Current Assets:			
Current Assets:			
Debtors	1,800	1,950	2,150
Stock	1,900	2,050	2,700
Cash & Bank	800	800	800
Others	550	750	1,800
	5,050	5,550	7,450
Less: Current Liabilities	900	1,650	3,100
B.	4,150	3,900	4,350
Total Assets [A+B]	7,750	7,850	8,400
Sales	4,050	4,200	5,400

A) Calculate &analyse for the year 2016-17 and 2017-18:

i. Fixed Asset Turnover Ratio

ii. Stock Turnover Ratio

iii. Debtors' 'Turnover Ratio in terms of number of days'

iv. Debt-Equity Ratio

v. Current assets to current liability

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

SOLUTION:

Calculation of ration for the year 2016-17 & 2017-18

	2016-17	2017-18
(i) Fixed Asset Turnover Ratio $\frac{\text{Sales}}{\text{Average Fixed Assets}}$	$\frac{4,200}{2,075}$ = 2.02 times	$\frac{5,400}{2,175}$ = 2.48 times
(ii) Stock Turnover Ratio $\frac{\text{Sales}}{\text{Average Stock}}$	$\frac{4,200}{1,975}$ = 2.13 times	$\frac{5,400}{2,375}$ = 2.27 times
(iii) Debtors' Turnover Ratio [in term of no. of days' sales $\frac{\text{Average Receivables}}{\text{Credit Sales}} \times$ No. of days in the year	$\frac{1,875}{4200}$ x 365 = 163 days	$\frac{2,050}{5400}$ x 365 =138 days
(iv) Debt-Equity Ratio $\frac{\text{Debt}}{\text{Equity}}$	1,550/ 6,300 =0.25	2,600/ 5,800 = 0.45
(v) Current Ratio = Current Assets/ Current liability	5,550/1,650 = 3.36	7,450/3,100 = 2.40

Working Notes

1. Calculation of Average Fixed Asset (Net)

   In 2016 -17:

   Average Fixed Assets (Net) = (2,000 + 2,150)/2 = Rs.2,075 lakhs

   In 2017 – 18:

   Average Fixed Assets (Net) = (2,150 + 2,200)/2 =Rs.2,175 lakhs

2. Calculation of Average Stock

   In 2016 – 17:

   Average Stock = (1,900 + 2,050)/2 =Rs. 1,975 lakhs

   In 2017 – 18:

   Average Stock = (2,050 + 2,700)/2 = Rs.2,375 lakhs

3. Calculation of Average Receivables

   In 2016-17

   Average Receivables = (1,800 + 1,950)/2 = Rs.1,875 lakhs

   In 2017-18

   Average Receivable = (1,950 + 2,150)/2 =Rs. 2,050 lakhs

4. Debtor's turnover ratio in terms of days

   $\frac{\text{No. of days in a year}}{\text{debtor's Turnover ratio}}$

   = Average Receivables / Credit Sales x No. of days in the year

5. Debt/ Equity ratio

Debt = Long term loan In

2016-17 =Rs. 1,550 lakhs

In 2017-18 =Rs. 2,600 lakhs

Equity = Equity share capital + Reserve & SurplusIn

2016-17 = 2,200 + 2,000 + 2,100 = Rs.6,300 lakhs

In 2017 -18 = 3,200 + 700 + 1,900 = Rs.5,800 lakhs

WASTE MULTIPLIER

ILLUSTRATION 6.

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

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

From the above, calculate the process wise waste multiplier factor.

SOLUTION:

Process	% of wastages on input	Net output for 100 unitsof input	Waste multiplier
Total	-	100	1.3161
Blow Room	9.18	100 - 9.18 = 90.82	1.1953
Carding	7.17	90.82 - 6.51 = 84.31	1.1096
Drawing	1.10	84.31 - 0.93 = 83.38	1.0974
Roving(Simplex)	0.30	83.38 - 0.25 = 83.13	1.0941
Ring Frame(Spinning)	7.21	83.13 - 5.99 = 77.14	1.0153

Reeling and Winding	1.50	77.14 - 1.16 = 75.98	1.0000

Calculation = 1/75.98 = 0.013161.

ILLUSTRATION 7.

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

Blowroom :	Cotton processed Laps produced	4672563 kgs 4258274 kgs.
Carding :	Laps processed Silvers produced	4274362 kgs. 3976420 kgs.
Draw frames :	Silvers processed Silvers drawn	3948241 kgs. 3901810 kgs.
Roving (Simplex) :	Drawn silvers processed Transferred to Ring frame	3874125 kgs. 3831510 kgs.
Ring frame :	Silvers used Finished Yarn produced	3911645 kgs. 3641741 kgs.
Reeling and Winding :	Yarn wound Salable Yarn produced	3635420 kgs. 3580889 kgs.

CALCULATE THE PROCESSWISE WASTE MULTIPLIER FACTORS.

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

SOLUTION:

Process	Input (kgs)	Output (kgs) %	Loss (%)	Output (%)	Waste Multiplier
Total Consumption				100.00	1.3161
Blowroom :	4672563 kgs	4258274 kgs.	8.87	91.13	1.1994
Carding :	4274362 kgs.	3976420 kgs.	6.97	84.78	1.1158
Draw frames :	3948241 kgs.	3901810 kgs.	1.18	83.78	1.1026
Roving (Simplex) :	3874125 kgs.	3831510 kgs.	1.10	82.86	1.0905
Ring frame :	3911645 kgs.	3641741 kgs.	6.90	77.14	1.0153
Reeling and Winding :	3635420 kgs.	3580889 kgs.	1.50	75.98	1.0000

LOSS PERCENTAGE = (INPUT-OUTPUT)/INPUT × 100

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STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

ILLUSTRATION 8.

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

(i) **Value Added.**

(ii) **Ratio of Operating Profit to Sales.**

(iii) **Ratio of Operating Profit to Value Added.**

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

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

SOLUTION:

(i)	Computation of Value Added	Rs. in lakhs	Rs. in lakhs
	Net Sales+ Increase in Stock of Finished Goods		21,250
	Less:		
	Cost of bought out materials and services:		
	Raw Materials	2,600	
	Packing Materials	1,200	
	Stores and Spares	560	
	Power and fuel	4,600	
	Repairs and Maintenance	200	
	Insurance	120	
	Other factory overhead	250	
	Other Selling & distribution overhead	1,700	
	Other Administration overhead	80	11,310
	Value Added		9,940
	Composition of Value Added:		
	Depreciation	885	
	Interest	1,398	
	Salaries and wages (480+240+120+120)	960	3,243
	Profit before tax (balancing figure)		6,697
	Operating Profit:		
	PBT	6,697	
	Interest paid	1,398	
			8,095

(ii) Ratio of operating profit to net sales =

Operating profit / Net Sales

= 8,095 / 21,000 × 100 = 38.55

(iii) Ratio of operating profit to value added =

Operating profit / Value Added = 8,095 / 9,940 × 100 = 81.44

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

ILLUSTRATION 9.

The president of the H T Company has just returned from a management seminar in which the benefits of economic value added have been trumpeted. He wants to know what the calculation would be for HT, and asks his financial analyst to find out.

The financial analyst knows that the company's cost of capital is 12.5%, having recently calculated it from the company's mix of debt, preferred stock, and common stock. He then reconfigures information from the income statement and balance sheet into the following matrix, where some expense line items are instead treated as investments.

Account Description	Performance	Net Investment
Revenue	$6,050,000	
Cost of goods sold	4,000,000	
General & administrative	660,000	
Sales department	505,000	
Training department		$75,000
Research & development		230,000
Marketing department	240,000	
Net income	$645,000	
Fixed assets		3,100,000
Cost of patent protection		82,000
Cost of trademark protection		145,000
Total net investment		$3,632,000

The return on investment for HT is 17.8%, using the information from the preceding matrix. The calculation is $645,000 of net income divided by $3,632,000 of net investment. Finally, he includes the return on investment, cost of capital, and net investment to calculate Economic Value Added.

Find the EVA.

SOLUTION:

($3,632,000 Net investment) x (17.8% Actual return – 12.5% Cost of capital)

= $3,632,000 Net investment x 5.3%

= $192,496 Economic value added

Thus, the company is generating a healthy economic value on the funds invested in it.

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

INVENTORY VALUATION

ILLUSTRATION 10.

Purchase of Materials $ 50,000 [Forward contract rate $ = Rs.54.40 but $ = Rs.54.60 on the date of importation] ; Import Duty paid Rs.5,65,000; Freight inward Rs.1,62,000 ; Insurance paid for import by road Rs.48,000; Cash discount Rs.33,000; Payment made to the foreign vendor after a month, on that date the rate of exchange was $ = Rs.55,20. Computethe landed cost of material.

SOLUTION:

Computation of Landed Cost of Material:

	Particulars	Amount (Rs.)
	Purchase price of Material [50,000 x 54.60]	27,30,000
Add	Import Duties of purchasing the material	5,65,000
Add	Any taxes paid during the purchase of material	1,62,000
Add	Freight Inward during the procurement of material	48,000
	Value of Receipt of Material	35,05,000

(i) Excess payment made to the vendor due to exchange fluctuation is not an includible cost, hence not considered.

(ii) Though the forward contract rate was $ = Rs.54.40, but the exchange rate on the date of importation is considered. Hence, included in the cost of materials. Accordingly, the purchase cost is computed considering the $ = Rs.54.60.

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STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

RECONCILIATION STATEMENT

ILLUSTRATION 11.

The financial profit and loss account for the year 2017-18 of a company shows a net profit of Rs.26,28,000. During the course of cost audit, it was noticed that:

(i) The company was engaged in trading activity by purchasing goods at Rs.4,00,000 and selling it for Rs.5,00,000 after incurring and expenditure of Rs.25,000.

(ii) Some old assets sold off at the end-end fetching a profit of Rs.80,000

(iii) A major overhaul of machinery was carried out at a cost of Rs.4,00,000. And the next such overhaul will bedone only after four years.

(iv) Interest was received amounting to Rs.1,50,000 from outside investments.

(v) Work-in-progress valuation for financial accounts does not as a practice take into account factory overhead.
Factory overhead was Rs.1,85,000 in opening WIP and Rs.3,15,000 in closing WIP.

WORK OUT THE PROFIT AS PER COST ACCOUNTS AND BRIEFLY EXPLAIN THE ADJUSTMENT, IF ANY, CARRIED OUT.

SOLUTION:

RECONCILIATION STATEMENT

			Rs.	Rs.
Profit as per Cost Accounts				**27,53,000**
Less:	1.	**Proportionate Charge i.e., three-fourth for overhaul of machinery not provided in cost accounts**	**3,00,000**	
	2.	**Difference in the valuation of work-in-progress**	**1,30,000**	**4,30,000**
Add:	1.	**Trading profit not included in cost accounts**	**75,000**	
	2.	**Profit on sale of old assets**	**80,000**	
	3.	**Interest received on outside investment**	**1,50,000**	**3,05,000**
Profit as per Financial Profit & Loss Account				**26,28,000**

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

ILLUSTRATION 12.

The following figures are extracted from the Financial Accounts of BSL Ltd. for the year ended 31-03-2018:

	Rs.	Rs.
Sales (20,000 units)		50,00,000
Materials		20,00,000
Wages		10,00,000
Factory Overheads		9,00,000
Administrative Overheads		5,20,000
Selling and Distribution Overheads		3,60,000
Finished Goods (1,230 units)		3,00,000
Work-in-progress:		
Materials	60,000	
Labour	40,000	
Factory Overheads	40,000	1,40,000
Goodwill Written off		4,00,000
Interest paid on capital		40,000

In the costing records, Factory Overhead is charged at 100% of Wages, Administration Overhead 10% factory cost and Selling and Distribution Overhead at the rate of Rs. 20 per unit sold.

Prepare a statement reconciling the profit as per Cost Records with the profit as per Financial Records.

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SOLUTION:

BSL Ltd.

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

Profit & Loss Account

(For the year ended 31st March, 2018)

Dr. **Cr.**

Particulars	Rs. in Lakhs	Particulars	Rs. in Lakhs
To Opening Stock	**Nil**	**By Sales (20,000 units)**	**50,00,000**
To Materials	**20,000**	**By Closing Stock (1,230 units)**	**3,00,000**
To Wages	**10,00,000**	**By Work-in-progress**	**1,40,000**
To Factory Overheads	**9,00,000**		
To Administrative Overheads	**5,20,000**		
To Selling & Distribution Overheads	**3,60,000**		
To Goodwill written off	**4,00,000**		
To Interest on Capital	**40,000**		
To Net Profit	**2,20,000**		
	54,40,000		54,40,000

COST PROFIT & LOSS STATEMENT

(FOR THE YEAR ENDED 31ST MARCH, 2018)

Particulars	Rs. in Lakhs
Materials	**20,00,000**
Wages	**10,00,000**
Prime Cost	**30,00,000**
Add: Factory Overhead @ 100% of wages	**10,00,000**
	40,00,000
Less: Closing Work-in-progress	**1,40,000**
Factory Cost (20,000 + 1,230) units	**38,60,000**
Administrative Overheads @ 10% of Factory Cost	**3,86,000**
	42,46,000
Less: Closing Stock of Finished Goods 1,230 units (See Note)	**2,46,000**
Cost of Production (20,000 units)	**40,00,000**
Selling & Distribution Overhead @ Rs.20 per unit	**4,00,000**
Cost of Sales (20,000 units)	**44,00,000**
Sales Revenue (20,000 units)	**50,00,000**
Profit	6,00,000

Note: Cost of 21,230 units is Rs.42,46,000. Therefore, the cost of one unit is Rs.200. Hence the cost of 1,230 units is Rs. 2,46,000.

Alternatively: Administrative overheads could be excluded from the cost of production.

RECONCILIATION STATEMENT

Particulars	Rs.	Rs.
Profit as per Cost Records		**6,00,000**
Add: Factory Overheads over-absorbed (Rs. 10,00,000 – Rs. 9,00,000)	**1,00,000**	
Selling & Distribution Overhead Over-absorbed (Rs. 4,00,000 – Rs. 3,60,000)	**40,000**	
Difference in the valuation of closing stock of finished goods (Rs. 3,00,000 – Rs. 2,46,000)	**54,000**	**1,94,000**
		7,94,000
Less: Administrative Overhead Under-absorbed (Rs. 5,20,000 – Rs. 3,86,000)		**1,34,000**
Goodwill written off relates to Financial Accounts		**4,00,000**
Interest on Capital	**40,000**	**5,74,000**
Profit as per Financial Accounts		2,20,000

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ILLUSTRATION 13.

The profit as per Financial A/c of DGL Cement Ltd. for the year 2017-18 was Rs. 1,34,27,516. The

profit as per Cost Accounting records showed a different figure. You are required to prepare a reconciliation statement and arrive at a profit as per Cost Accounts. The following details were collected from Financial Accounting and Cost Accounting records.

	Rs.	Rs.
	Financial A/c	**Cost A/c**
Opening WIP	**29,52,315**	**23,45,720**
Opening Finished Goods	**2,48,37,410**	**2,72,16,930**
Closing WIP	**41,72,635**	**36,35,345**
Closing Finished Goods	**3,67,51,410**	**4,15,24,148**
Interest income from inter corporate deposits	**6,14,250**	**–**
Donations given	**4,75,250**	**–**
Loss on sale of Fixed Assets	**1,04,148**	**–**
Value of cement taken for own consumption	**3,75,920**	**3,45,200**
Cost of power drawn from own wind mill:		
At EB Tariff		**48,58,415**
At Cost	**34,10,420**	

SOLUTION:

Sl. No.	Particulars	Current Year
1	**Profit or Loss as per Cost Accounting Records**	**1,43,76,472**
2	**Add: Incomes not considered in cost accounts:**	
	(a) Interest income from inter corporate deposits	**6,14,250**
3	**Less: Expenses not considered in cost accounts:**	
	(a) Loss on sale of Fixed Asset	**1,04,148**
	(b) Donations not considered in Cost Accounts	**4,75,250**
4	**Add: Diff. in value of cement taken for own consumption**	**30,720**
	Add: Diff. in valuation of wind mill power	**14,47,995**
	Less: Difference in stock valuation	**24,62,523**
5	Profit or Loss as per Financial Accounts	**1,34,27,516**

ILLUSTRATION 14.

Abridged Cost Statement & Profit Reconciliation Statement

STUDY NOTE 12 CASE STUDY ON PERFORMANCE ANALYSIS

XYZ Ltd a Power Generation Company showing its Profit and Loss Statement as below.

STATEMENT OF PROFIT AND LOSS FOR THE YEAR ENDED 31ST MARCH 2018

SNO.	Particulars	For the year ended 31-03-2018
I	**Revenue from operation**	**8,28,000.00**
II	**Other Income**	**42,200.00**
III	**Total Revenue (I+II)**	**8,70,200.00**
IV	**Expenses :**	
	a) Cost of Material Consumption	**6,10,700.00**
	b) Cost of utilities	**35,000.00**
	c) Employee cost	**41,800.00**
	d) Finance Cost	**50,220.00**
	e) Depreciation and Amortisation Expenses	**25,100.00**
	f) Other Expenses	**54,700.00**
	g) Interest and Financial Charges	**5,000.00**
V	**Total Expenses (a to g)**	**8,22,520.00**
VI	**Profit Before Exceptional Items And Tax (III-V)**	**47,680.00**
VII	**Exceptional Items**	**30,000.00**
VIII	Profit after Exceptional item (VI-VII)	**17,680.00**

On review of the Financial Statement, following information's are obtained.

(I) Cost of Material includes of Rs. 29,325 for Prior period adjustment

(II) Employee Exp. Includes -

- **(a) Employee Exp. of Rs. 3,280 includes arrear salary for earlier year.**
- **(b) Employee Exp. of Rs. 2,100 for VRS expenses.**

(III) Other Expenses includes -

- **(a) Rebate to Consumer of Rs. 2,056**
- **(b) Repair and Maintenance of Rs. 18,012**
- **(c) Corporate Social Responsibility of Rs. 5,118**
- **(d) Demurrage Charges of Rs. 1,998**

(e) Commission on Sale of Scrap of Rs. 1,000

(IV) Other Income includes -

(a) Sale of Scrap of Rs. 12,200

(b) Sale of Fly Ash of Rs. 20,480

(c) Profit on Sale of Fixed Assets of Rs.

9,520 Actual Production and Sales Quantity

- 1,80,000

Prepare Cost Sheet And Reconciliation Statement For the Financial 2017-18

SOLUTION:

Name of the Company: XYZ Power Generation

Corporation Ltd. Financial Year : 2017-18

PART-B

2. ABRIDGED COST STATEMENT

Name of Product			Thermal Electricity	
CETA heading			2716	
Unit of Measure			MU	
	Year	**Production**	**Other Adjustments**	Quantity Sold
	Current Year	**1,80,000.00**	-	1,80,000.00
			Current Year	
Sl. No.	**Particulars**		**Amount in Rupees**	Rate per Unit (`)
1	**Materials Consumed (Working Note-I)**		**5,81,375.00**	3.23
2	**Cost of Utilities**		**35,000.00**	0.19
3	**Direct Employees Cost (Working Note-II)**		**37,120.00**	0.21
4	**Repairs & Maintenance**		**18,012.00**	0.10
5	**Depreciation/Amortization**		**25,100.00**	0.14
6	**Other Expenses (Working Note-III)**		**21,516.00**	0.15

7	**Total (1 to 6)**	**7,18,123.00**	3.87
8	**Administrative Overheads**	**50,220.00**	0.28
9	**Cost of Sales before Interest (7 + 8)**	**7,73,343.00**	4.15
10	**Interest and Financial charges**	**5,000.00**	0.03
11	**Cost of Sales (9 + 10)**	**7,78,343.00**	4.18
12	**Net Sales Realization (Net of Taxes and Duties)**	**8,28,000.00**	4.60
13	Margin Profit/(Loss) as per Cost Accounts (12-11)	49657.00	0.45

Note:

1. **Out of Total Voluntary Retirement payment, only 1/3 charge has been considered as Cost and balance 2/3 charge as deferred expenses to be considered in subsequent years and considered Non-cost for the year .**
2. **It is assumed that the full amount of Exceptional items are Non-Cost in nature. So, shown in reconciliationstatement.**

Working Note I : Calculation of Material Consumed:

Cost of Material as per P/L Statement	6,10,700.00
Less- Prior period of Material Cost	29,325.00
Charge to Cost	5,81,375.00

Working Note II : Calculation of Employee Cost:

Employee cost as per profit and Loss Statement	41,800.00
Less: Voluntary Retirement Scheme (Note - 1)	1,400.00
Less: Arrear Salary for Prior period	3,280.00
Charge to Cost	37,120.00

Working Note III : Calculation of Other Expenses:

Other Expenses as per P/L A/c	54,700.00
Less: (a) Rebate to Consumer	2,056.00
(b) Repair and Maintenance	18,012.00
(c) Corporate Social Responsibility	5,118.00
(d) Demurrage Charges	1,998.00
(e) Commission on Sale of Scrap	1,000.00
Charge to Cost	26,516.00

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ABRIDGED COST STATEMENT

2. ABRIDGED COST STATEMENT (for each service separately)					
Name of Service					
Service Code (if applicable)					
Unit of Measure					
		Services Provided	Captive Consumption	Other Adjustments	Services rendered
	Current Year				
	Previous Year				

Sl. No.	Particulars	Current Year		Previous Year	
		Amount (Rs.)	Rate per Unit (Rs.)	Amount (Rs.)	Rate per Unit (Rs.)
1	Materials Consumed (specify details as per Para 2A)				
2	Utilities (specify details as per Para 2B)				
3	Direct Employees Cost				
4	Direct Expenses				
5	Consumable Stores and Spares				
6	Repairs and Maintenance				
7	Quality Control Expenses				
8	Research and Development Expenses				
9	Technical know- how Fee / Royalty, if any				
10	Depreciation/Amortization				
11	Other Overheads				
12	Industry Specific Operating Expenses (specify details as per Para 2 C)				
13	**Total (1 to 12)**				
14	Less: Credits for Recoveries, if any				
15	Cost of Services provided (13 - 14)				
16	Cost of Outsourced/Contractual Services				
17	Total Services available (15 + 16)				
18	Less: Self/Captive Consumption				
19	Other Adjustments (if any)				
20	Cost of Services Sold (17 - 18 + 19)				
21	Administrative Overheads				
22	Selling and Distribution Overheads				
23	Cost of Sales before Interest (20+21+22)				
24	Interest & Financing Charges				
25	Cost of Sales (23 + 24)				
26	Net Sales Realization (Net of Taxes and Duties)				
27	Margin [Profit/(Loss) as per Cost Accounts] (26 - 25)				

NOTES:	
1.	Separate Cost Statement shall be prepared for each service
2.	The items of cost shown in the proforma are indicative and the same shall be reflected keeping in mind the materiality of the Item of cost in the service.
3.	The Proforma may be suitably modified to meet the requirement of the Industry/service.
4.	In case the Company follows a pre-determined or standard costing system, the above cost statement shall reflect figures at actuals after adjustment of variances, if any.

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ABRIDGED COST STATEMENT

2A. Details of Materials Consumed

Name of Service									
Service Code (if applicable)									
Sl. No.	Description of Material	Category	UOM	Current Year			Previous Year		
				Quantity	Rate per Unit (Rs.)	Amount	Quantity	Rate per Unit (Rs.)	Amount
1.									
2.									
3.									
4.									
5.									
6.									
7.									
8.									
9.									
10.									

Category: Indigenous/ Imported/ Self Manufactured.

2B. Details of Utilities Consumed

Name of Service								
Service Code (if applicable)								
Sl. No.	Description of Material	UOM	Current Year			Previous Year		
			Quantity	Rate per Unit (Rs.)	Amount	Quantity	Rate per Unit (Rs.)	Amount
1.								
2.								
3.								
4.								
5.								
6.								
7.								
8.								
9.								
10.								

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ABRIDGED COST STATEMENT

2C. Details of Industry Specific Operating Expenses

Name of Service			
Service Code (if applicable)			
Sl. No.	Description of Industry Specific Operating Expenses	Current Year Amount	Previous Year Amount
1.			
2.			
3.			
4.			
5.			
6.			
7.			
8.			
9.			
10.			

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IMPORTANT FAQ

1. **What constitutes the cost records under Rule 2(e) ?**

CONCLUSION:

As per Rule 2(e) the Companies (Cost Records and Audit) Rules, 2014, "cost records" means 'books of account relating to utilization of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in section 148 of the Act and these Rules'. There cannot be any exhaustive list of cost accounting records. Any transaction - statistical, quantitative or other details - that has a bearing on the cost of the product/activity is important and form part of the cost accounting records.

Cost records are to be kept on regular basis to make it possible to "calculate per unit cost of production/ operations, cost of sales and margin for each of its products for every financial year on monthly/quarterly/ half-yearly/annual basis". What is required is to maintain such records and details in a structured manner on a regular basis so that accumulation is possible on a periodical basis.

2. **What is the meaning of "Turnover" in relation to the Companies (Cost Records and Audit) Rules, 2014?**

CONCLUSION:

Sub-section 91 of Section 2 of the Companies Act, 2013 defines "turnover" as "the aggregate value of the realization of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year. For the purposes of these Rules, "Turnover" means gross turnover made by the company from the sale or supply of all products or services during the financial year. It includes any turnover from job work or loan license operations but exclude duties and taxes. Export benefit received should be treated as a part of sales.

3. **Whether overall annual Turnover/individual turnover definition will include other operational income like Job work income, scrap sale, trading turnover, export benefits, sales of services etc.?**

CONCLUSION:

The Turnover shall include other operational income like Job work income, scrap sale, trading turnover, export benefits, sales of services etc.

4. **Is maintenance of cost accounting records mandatory for a multi-product company where all the products are not covered under the Rules even if the Turnover of the individual product/s that are covered under the Rules is less than rupees thirty five crores?**

CONCLUSION:

The Rules provide threshold limits for the company as a whole irrespective of whether all its products are as per the prescribed industry/sector provided under Table A or Table B. The Rules do not provide any minimum product specific threshold limits for maintenance of cost accounting records and consequently the company would be required to maintain cost accounting records for the products covered under Table-A or Table-B or both even if the turnover of such products is below rupees thirty five crores.

5. **What is the difference between Cost Accounting policy and Cost Accounting system?**

CONCLUSION:

Cost Accounting Policy of a company state the policy adopted by the company for treatment of individual cost components in cost determination.

The Cost Accounting system of a company, on the other hand, provides a flow of the cost accounting data/ information across the activity flow culminating in arriving at the cost of final product/service.

6. **A company meets the threshold limits for both maintenance of cost records and cost audit in Year-0 (previous year) and consequently comes under the purview of the Rules in Year-1 (current year). If the turnover of company gets reduced to lower than the prescribed threshold limit in Year-1 (current year), whether Cost Records and Cost Audit will be applicable for Year-2 (next year).**

CONCLUSION:

Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 states that a company engaged in the production of the goods or providing of services as prescribed having an overall turnover from all its products and services of rupees thirty five crore or more during the immediately preceding financial year, shall include cost records for such products or services in their books of account. Since the threshold limit for applicability of maintenance of cost accounting records is met in Year-0, the cost records are required to be maintained from Year-1. Once the maintenance of cost records becomes applicable, it would be maintained on a continuous basis in the subsequent years also. In the same line, cost audit will be applicable from Year-1 and for every year thereafter.

7. **Whether separate Form CRA-2 is required to be filed by a company having two or more different types of products covered under cost audit?**

CONCLUSION:

CRA-2 Form (intimation for appointment of cost auditor to Central Government) has replaced the earlier Form 23C (application seeking approval for appointment of cost auditor). A single Form CRA-2 is required to be filed providing details of the sectors/industries covered under cost audit and details of cost auditor. For Companies appointing multiple cost auditors, only one single Form CRA-2 is required to be filed. Provision has been made in the Form to accommodate details of multiple cost auditors.

8. **What is meant by Telecommunication Services and what is its coverage?**

CONCLUSION:

The Companies (Cost Records and Audit) Rules, 2014 has covered "Telecommunication services made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997 (24 of 1997)".

The Telecom Regulatory Authority of India Act, 1997 defines "telecommunication service" as "service of any description (including electronic mail, voice mail, data services, audio text service, video text services, radio paging and cellular mobile telephone services) which is made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature, by wire, radio, visual or other electro-magnetic means but shall not include broadcasting services".

Subsequently, the Central Government has included broadcasting services within the limit of telecommunication services by notifying "broadcasting services and cable services to be telecommunication service". [Notification No. 39 issued by Ministry of Communication and Information Technology dated 9 January 2004, S.O. No. 44(E) issued by TRAI, vide F. No. 13-1/2004].

In view of the above, Telecommunication Services made available to users and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997 would include all such services being regulated by TRAI including broadcasting services.

9. What is the coverage of "Roads and other infrastructure projects" under Item 10 of Table B of the Rules?

CONCLUSION:

"Roads and other infrastructure projects" has been defined to be corresponding to para No.(1)(a) as specified in Schedule VI of the Companies Act, 2013. Sub-clause (a) to Para (1) of Schedule VI of the Companies Act, 2013 covers "Roads, national highways, state highways, major district roads, other district roads and village roads, including toll roads, bridges, highways, road transport providers and other road-related services". Hence, every activity including construction and maintenance of the above projects are covered under the Rules.

10. What is the coverage of Construction Industry under Item 21 of Table B of the Rules?

CONCLUSION:

Construction Industry has been defined to be corresponding to para No. (5)(a) as specified in Schedule VI of the Companies Act, 2013. Para (5) of Schedule VI of the Companies Act, 2013 pertains to "Industrial, commercial and social development and maintenance" and covers "real estate development, including an industrial park or special economic zone" as per sub-clause (a). Hence, every construction activity in relation to the above are covered under the Rules.

11. What is the coverage of Aeronautical Services?

CONCLUSION:

Clause 3(B)(8) of the Companies (Cost Records and Audit) Rules, 2014 covers under the limit of the Rules "Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008)".

The Airports Economic Regulatory Authority of India Act, 2008 has defined "aeronautical services" as follows:

(i) For navigation, surveillance, and supportive communication thereto for air traffic management;
(ii) For the landing, housing or parking of an aircraft or any other ground facility offered in connection with aircraft operations at an airport;
(iii) For ground safety services at an airport;
(iv) For ground handling services relating to aircraft, passengers and cargo at an airport;
(v) For the cargo facility at an airport;
(vi) For supplying fuel to the aircraft at an airport;

The Rule has covered all the above services under the limit of maintenance of cost accounting records and cost audit subject to threshold limits.

However, all airports and aircraft operations belonging to or subject to the control of the Armed Forces or paramilitary Forces of the Union are excluded from the scope of these Rules.

12. Whether maintenance of cost accounting records and cost audit thereof, subject to threshold limits prescribed, is applicable to products which are for 100% captive consumption?

CONCLUSION:

The Companies (Cost Records and Audit) Rules, 2014 has specified different products and services for which maintenance of cost accounting records and cost audit thereof, subject to threshold limits prescribed, is mandatory.

In case a product is manufactured and 100% captively consumed for production of some other product which is also covered under these Rules and is subject to cost audit, then the cost of such captively consumed product would form part of the final product which is also under cost audit and as such a separate cost audit report for the captively consumed product will not be necessary.

However, if the product is partly for captive consumption and partly sold, or if the product is 100% captively consumed for production of some other product which is not covered under these Rules, then cost audit would be applicable for such captively consumed product(s).

13. What would be the treatment of cost consumption of electricity from a captive generating plant and applicability of cost audit to such captive generating plants?

CONCLUSION:

Rule 3(A)(2) dealing with generation, transmission, distribution and supply of electricity has excluded captive generation as defined in the Electricity Rules, 2005. It may be noted that in case of a company whose product(s)/service(s) are covered under the Rules and it consumes electricity from the captive generating plant, determination of cost of generation, transmission, distribution and supply of electricity as per CRA-1 would be mandatory since the cost of consumption of electricity has to be at cost.

Hence, maintenance of cost records for generation, transmission, distribution and supply of electricity would be applicable. However, cost audit will not be applicable to such captive plants, provided the entire generation is consumed captively and no portion is sold outside.

14. A Company is engaged in both Regulated and Non-Regulated sectors and all its products are not covered under the Rules. How to determine applicability of cost audit for the products covered under the Regulated and Non-Regulated sectors since different threshold limits have been prescribed under Rule 4?

CONCLUSION:

Rule 4 states that cost audit would be applicable for products under:
(a) Table A if the overall turnover of the company is at least Rs. 50 crore and
(b) Table B if the overall turnover of the company is Rs. 100 crore.

Hence, the coverage of cost audit for a company where all its products are covered under Table A or Table B or a combination of the two would be guided by these threshold limits.
In case of a multi-product company where all its products are not covered under Table A or Table B or a combination of both, then the following would apply:

(a) If the overall turnover of the company is more than Rs. 50 crore but less than Rs.100 crore, then only products covered under Table-A will be covered under cost audit provided the sum total of all the products of the company covered under Table A and Table B is more than Rs. 25 crore.
(b) If the overall turnover of the company is more than Rs.100 crore, then:
(i) products under both Table A and Table B will be covered under cost audit provided the sum total of all the products of the company covered under Table A and Table B is more than Rs. 35 crore
(ii) only products of Table A will be covered if the sum total of all the products of the company covered under Table A and Table B is more than Rs. 25 crore but less than Rs. 35 crore.

Explanation: Rule 4 has defined threshold limits for Table A and Table B separately but the aggregate turnover of the individual product or products or service or services has been defined to be all products for which cost records are required to be maintained under rule 3.

15. A company does job work for others. The raw materials are supplied to the company by the principal and the job worker gets conversion charges only. The Job Worker company pays the GST which is reimbursed by the principal. Will the job worker be covered under the Companies (Cost Records and Audit) Rules, 2014?

CONCLUSION:

The Rules are applicable to a company. If the products of the Job Worker is listed under Table A or Table B of the Rules and the Job Worker company meets the threshold limits as prescribed, then the job worker company will be required to maintain cost accounting records. If the threshold criteria of the cost audit as prescribed are met, the company would be covered under cost audit also. Payment of GST by the Job Worker and in turn getting reimbursement for it is immaterial for application of the Rules.

16. Whether companies registered under Section 8 of the Companies Act, 2013 (corresponding to Section 25 of the Companies Act, 1956) and One Person Company (OPC) introduced in Companies Act, 2013 covered under the Rules?

CONCLUSION:

The Companies (Cost Records and Audit) Rules, 2014 are applicable to every company registered under the Companies Act, 2013 which are engaged in production of goods or providing of services listed in Table-A or Table-B of Rule 3.

Different threshold limits have been prescribed in the Rules for applicability of maintenance of cost accounting records and coverage under cost audit. Exemption has been granted only to companies which are classified as a micro enterprise or a small enterprise including as per the turnover criteria under sub-section (9) of section 7 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006) and foreign companies having only liaison offices engaged in Production, import and supply or trading of medical devices specified under Item 33 of Table-B of Rule 3.

Any other legal entity registered as a company that meets the conditions stated in Rule 3 and Rule 4 are covered.

17. The manufacturing process of a company generates Metal Scrap during production of its main products which may or may not be covered under cost audit. Such scrap is sold in the market after the same is cleared under CETA Codes that are covered in the Rules. Will the company be covered under cost audit for generation of scrap?

CONCLUSION:

Generation of scrap is not a production or processing or manufacturing but is incidental to manufacture of its main products. The Rules are applicable to production of goods or providing of services. CETA Codes have been inducted in the Rules for proper identification of Products that are manufactured. The act of payment of GST is immaterial in the context of application of the Rules. The generation of scrap and its consequent sale in the market cannot be construed to be covered under the Rules.

18. Whether Value Addition and Distribution of Earnings [Part D, Para 3] is to be computed based on Cost record data or audited financial data?

CONCLUSION: Value Addition statement is to be computed based on audited financial accounts.

19. Whether Financial Position and Ratio Analysis [Part D, Para 4] is to be computed based on Cost record data or audited financial data?

CONCLUSION: Financial Position and Ratio Analysis is to be computed based on audited financial accounts. This reporting Para has been aligned with the nomenclature of Schedule III of the Companies Act, 2013.

20.What is the procedure for appointment of cost auditor under the Companies Act, 2013?

CONCLUSION:

The cost auditor is to be appointed by the Board of Directors on the recommendation of the Audit Committee, where the company is required to have an Audit Committee. The cost auditor proposed to be appointed is required to give a letter of consent to the Board of Directors.

The company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in **form CRA-2**, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

21.Who can be appointed as a cost auditor?

CONCLUSION:

Only a Cost Accountant, as defined under section 2(28) of the Companies Act, 2013, can be appointed as a cost auditor.

Clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 defines "Cost Accountant". It means a Cost Accountant who holds a valid certificate of practice under sub-section (1) of section 6 of the Cost and Works Accountants Act, 1959 and is in whole-time practice. Cost Accountant includes a Firm of Cost Accountants and a LLP of cost accountants.

22.What are the eligibility criteria for appointment as a cost auditor?

CONCLUSION:

Eligibility Criteria under Section 141 of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 and Section 148 of the Companies Act, 2013. The following persons are not eligible for appointment as a cost auditor:

(a) A body corporate. However, a Limited Liability partnership registered under the Limited Liability Partnership Act, 2008 can be appointed. [Section 141(3)(a)].
(b) An officer or employee of the company. [Section 141(3)(b)].
(c) A person who is a partner, or who is in the employment, of an officer or employee of the company. [Section 141(3)(c)].
(d) A person who, or his relative or partner is holding any security of or interest in the company or any of its subsidiary or of its holding or associate company or a subsidiary of such holding company. [Section 141(3)(d)(i)].

(e) Relatives of any partner of the firm holding any security of or interest in the company of face value exceeding Rs. 1 lakh. [Section 141(3)(d)(i) and Rule 10(1) of Companies (Audit and Auditors) Rules, 2014].
(f) A person who is indebted to the company or its subsidiary, or its holding or associate company or a subsidiary or such holding company, for an amount exceeding Rs. 5 lakhs. [Section 141(3)(d)(ii) and Rule 10(2) of Companies (Audit and Auditors) Rules, 2014].
(g) A person who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for an amount exceeding Rs. 1 lakh. [Section 141(3)(d)(iii) and Rule 10(3) of Companies (Audit and Auditors) Rules, 2014].
(h) A person or a firm who, whether directly or indirectly, has business relationship with the company or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company. [Section 141(3)(e) and

Rule 10(4) of Companies (Audit and Auditors) Rules, 2014].
"Business Relationship" is defined in Rule 10(4) of Companies (Audit and Auditors) Rules, 2014 and the same shall be construed as any transaction entered into for a commercial purpose, except commercial transactions which are in the nature of professional services permitted to be rendered by a cost auditor or a cost audit firm under the Act and commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the cost auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

(i) A person whose relative is a director or is in the employment of the company as a director or key managerial personnel of the company. [Section 141(3)(f)].
(j) A person who is in the full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor if such person or persons is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies. [Section 141(3)(g)].
(k) A person who has been convicted by a court for an offence involving fraud and a period of ten years has not elapsed from the date of such conviction. [Section 141(3)(h)].
(l) Any person whose subsidiary or associate company or any other form of entity, is engaged as on date of appointment in consulting and providing specialised services to the company and its subsidiary companies: [Section 141(3)(i) and Section 144].

(a) accounting and book keeping services
(b) internal audit
(c) design and implementation of any financial information system
(d) actuarial services
(e) investment advisory services
(f) investment banking services
(g) rendering of outsourced financial services
(h) management services

23. The Companies Act, 2013 has introduced provision regarding rotation of auditors. Is the provision of rotation of auditors applicable to cost auditors also?

CONCLUSION:

The provisions for maintenance of cost accounting records and cost audit are governed by Section 148 of the Companies Act, 2013. The provisions of Section 148 clearly states that no person appointed under Section 139 as an auditor of the company shall be appointed for conducting audit of cost records of the company.

Section 148 also provides that qualifications, disqualifications, rights, duties and obligations applicable to auditors (financial) shall apply to a cost auditor appointed under this section. The eligibility, qualifications and disqualifications are provided in Section 141 of the Act and powers and duties are provided in Section 143.

Section 143(14) specifically states that the provisions of Section 143 shall mutatis mutandis apply to a cost auditor appointed under Section 148. There are no other provisions governing the appointment of a cost auditor.

Section 139(3) of the Act, applicable to appointment of auditors (financial), and Rule 6 of Companies (Audit and Auditors) Rules, 2014 deals with the provision of rotation of auditors and these provisions are applicable only to appointment of auditors (financial).

The Act does not provide for rotation in case of appointment of cost auditors and the same is not applicable to a cost auditor. It may, however, be noted that though there is no statutory provision for rotation of cost auditors, individual companies may do so as a part of their policy, as is the practice with Public Sector Undertakings.

24. What is the procedure to be followed for fixing the remuneration of a cost auditor?

CONCLUSION:

Rule 14 of the Companies (Audit and Auditors) Rules, 2014 has laid down the procedure of appointment and fixing the remuneration of a cost auditor. It states as follows:

Remuneration of the Cost Auditor: For the purpose of sub-section (3) of section 148,—

(a) in the case of companies which are required to constitute an audit committee—

(i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;

(ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

(b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

25. What are the duties of the Companies in relation to provisions of Section 148 of the Companies Act, 2013 and the Rules framed thereunder?

CONCLUSION:

Every company required to get cost audit conducted under Section 148(2) of the Companies Act, 2013 shall:-

(a) Appoint a cost auditor within one hundred and eighty days of the commencement of every financial year;

(b) Inform the cost auditor concerned of his or its appointment;

(c) File a notice of such appointment with the Central Government within a period of thirty days of the

Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in **form CRA-2**, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014;

(d) Within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report alongwith full information and explanation on every reservation or qualification contained therein, in **form CRA-4** along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

26. Is a cost auditor required to audit and certify monthly, quarterly, half-yearly and yearly cost statements?

CONCLUSION:

As per Rule 5, every company under these rules including all units and branches thereof are required, in respect of each of its financial year, to maintain cost records in form CRA-1.

The cost records are required to be maintained on regular basis in such manner so as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

The cost auditor is appointed to conduct audit of the cost records and make report thereon for the financial year for which he is appointed. It is not depends upon the cost auditor to certify monthly, quarterly, half-yearly cost statements.

27. CRA-3 requires Details of Material Consumed, Details of Utilities Consumed and Details of Industry Specific Operating Expenses respectively [Part B and Part C, Para 2(a), 2(b) and 2(c)]. In case of companies where number of materials or utilities or industry specific operating expenses is more than 10 each, which items should be disclosed in the respective paras?

CONCLUSION:

It is to be noted that the cost audit report is required to be filed in XBRL mode and there is no provision for extending the number of items under any of the heads to accommodate more than 10 items. Hence, in cases where number of such items is more than 10 under any of the heads of material or utility or industry specific operating expenses, the 9 main items in terms of value should be provided separately and the balance items should be clubbed together under "Others" and shown as the tenth item.

28. Whether figures are to be provided for Rupees per Unit or Amount in Rupees in the Product and Service Profitability Statement [CRA-3, Part D, Para 1]?

CONCLUSION:

Amount in Rupees are required to be provided under this Para. The number of products or services will be equal to the number of products and services covered under cost audit and for which Abridged Cost Statement has been provided.

Raghav ACADEMY