

PAPER - 17: COST AND MANAGEMENT AUDIT

SUGGESTED ANSWERS

SECTION-A

1. (a)

- (i) A
- (ii) D
- (iii) A
- (iv) A
- (v) B
- (vi) D
- (vii) A
- (viii) D
- (ix) C
- (x) D

1. (b)

- (xi) A
- (xii) B
- (xiii) C
- (xiv) D
- (xv) A

SECTION – B

2. (a)

The General Objectives of Cost Audit:

1. Verification of cost accounts with a view to ascertaining that these have been properly maintained and compiled according to the cost accounting system followed by the enterprise.
2. Ensuring that prescribed procedures of the cost accounting records rules are duly adhered to.
3. Detection of errors and fraud
4. Verification of the cost of each “Cost unit” and “Cost Centre” to ensure that these have been properly ascertained.
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. Advising management, based on inter-unit/inter-firm comparison of cost records, as regards the areas where performance calls for improvement.
11. Promoting corporate governance through various operational disclosures to the directors.
12. Helping the entity in matters of Anti-Dumping Duty, valuation of cost of production of goods and services, anti-profiteering (e.g. GST), price controls (e.g. Pharma industry in the past), etc.

2. (b)

CRA-1: Forms in which cost records shall be maintained (Pursuant to rule 5(1))	The form CRA-1 prescribes the form in which cost records shall be maintained. The form categorises the requirement of maintaining proper details as per 31 headings. Inserted by the Notification Dated 3rd December 2018 (i) in Form CRA-1, paragraph number 31 shall be inserted, namely: - "31. Unit of Measurement (UOM). The Unit of Measurement (UOM) for each Customs Tariff Act Heading, wherever applicable, shall be the same as provided for in the Customs Tariff Act, 1975 (51 of 1975) corresponding to that particular Customs Tariff Act Heading."
CRA-2: Form of intimation of appointment of cost auditor by the company to Central Government. (Pursuant to rule 6(2) and 3(A))	<ol style="list-style-type: none">(1) Corporate Identity Number (CIN) or Foreign Company Registration Number (FCRN) of the company(2) General Information(3) Product(s)/Service(s) to which Cost Audit relates(4) Details of all the Cost Auditor(s) appointed(5) Financial year to be covered under the Cost Audit(6) Details of previous Cost Auditor who has not been reappointed(7) Attachments:<ul style="list-style-type: none">- Copy of the Board Resolutions of the company- Optional attachment – if any
CRA-3 Form of Cost Audit Report (Pursuant to rule 6(4))	Clause (vii) have been added to auditor's report as under: Detailed unit-wise and product/service-wise cost statements and schedules thereto. In respect of the product/services under reference of the company duly audited and certified by me/us are/are not kept in the company.
CRA-4 Form for filing Cost Audit Report with the Central Government (Pursuant to Rule 6(6))	<ol style="list-style-type: none">(1) Corporate Identity Number (CIN) or Foreign Company Registration Number (FCRN) of the company(2) General Information(3) Details of Industries/Sectors/Product(s)/Service(s) (CTA heading level, wherever applicable as per Rules for Regulated and Non-Regulated sector) for which the Cost Audit Report is being submitted(4) Details of Industries/Sectors/ Products(s) Services(s) (CTA heading level, wherever applicable as per Rules for Regulated and Non-Regulated sector) not covered in the Cost Audit Report.(5) Details of the cost auditor(s) appointed(6) Details of the observation of the Cost Audit Report(7) Attachment:<ul style="list-style-type: none">-XBRL document in respect of the cost audit report and Company's information and explanation on every Qualification and reservation contained therein.-Optional attachment, if any

3. (a)

The cost auditor is not subordinate to the financial auditor. Cost audit has its own scope, standards, and statutory backing under Section 148 of the Companies Act. Therefore, failure by the financial auditor does not relieve the cost auditor from performing their own due diligence. (Cost Audit happens post conclusion of Financial Audit). Cost Auditing Standard (CAS) 103 – Planning an Audit stipulates:

The cost auditor should design audit procedures to detect material misstatements due to fraud or error.

- According to Section 143(12) of the Companies Act 2013, if an auditor of a company, including a Cost Auditor, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:
- Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:
- Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.”
- It does not apply if the Auditor has acted in good faith.
- If the Cost auditor, among others, does not comply with the provisions of sub-section (12),
 - (a) in case of a listed company, be liable to a penalty of five lakh rupees; and
 - (b) in case of any other company, be liable to a penalty of one lakh rupees
- Matters are required to be reported immediately but not later than 2 days of his knowledge specifying:
 - (a) Nature of Fraud with description;
 - (b) Approximate amount involved; and
 - (c) Parties involved.
- Following disclosures are required to be made in Board's Report:
 - (a) Nature of Fraud with description;
 - (b) Approximate Amount involved;
 - (c) Parties involved, if remedial action not taken; and
 - (d) Remedial actions taken.

Alternative solution:

Alternatively, if read with the rule 13:

- According to Section 143(12) of the Companies Act 2013, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:
- The auditor shall report the matter to the Central Government as under:-
 - (a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days;

- (b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;
 - (c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations
- Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases immediately but not later than 2 days of his knowledge specifying:
 - (a) Nature of Fraud with description;
 - (b) Approximate amount involved; and
 - (c) Parties involved.
 - The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) of rule 13 during the year shall be disclosed in the Board's Report
 - (a) Nature of Fraud with description;
 - (b) Approximate Amount involved;
 - (c) Parties involved, if remedial action not taken; and
 - (d) Remedial actions taken.
 - Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.
 - It does not apply if the Auditor has acted in good faith.
 - If the Cost auditor, among others, does not comply with the provisions of sub-section (12),
 - (a) in case of a listed company, be liable to a penalty of five lakh rupees; and
 - (b) in case of any other company, be liable to a penalty of one lakh rupees.

3. (b)
 Sec. 148(3) of the Companies Act, 2013 states that cost audit shall be conducted by a Cost Accountant who shall be appointed by the Board. The steps for filing a cost audit report are:

- The cost auditor has to submit the report to the company within 180 days of the financial year's closure.
- The company submits the report to the Ministry of Corporate Affairs (MCA) within 30 days of receiving it from the cost auditor.
- The company must include full details and explanations for any reservations or qualifications made by the auditor. The company must submit the report with the cost auditor's digital signature.
- The cost audit report is filed in e-form CRA-4, which is an electronic form for filing the cost audit report with MCA. Requisite fees as per Rules are to be paid by the company.
- In case the company has got extension of time of holding AGM may file form CRA 4 within extended period filing.

Execution of Audit:

- (a) Performing the audit checks and procedures, as planned
- (b) Collecting all required audit evidence enabling the auditor to form his opinion.
 - (i) Validating their relevance and reliability
 - (ii) Checking their accuracy, completeness and sufficiency
 - (iii) Checking the source and consistency
- (c) Preparing draft observations and discussing with key management personnel
- (d) Preparing final audit report

4. (a)**TR LTD.****COMPUTATION OF DIRECT EXPENSES (As per CAS-10)**

Particulars	Amount in ₹	
	Product AB	Product AC
Royalty paid on Sale	4,45,000	3,65,000
Add: Royalty paid on Units Produced	2,75,000	2,22,500
Add: Hire Charges of equipment used in the manufacturing process of product - AB	60,000	-
Add Design Charges	1,68,000	1,90,000
Add: Software development Charges related to production	2,82,000	3,87,000
Direct Expenses (Total)	12,30,000	11,64,500

4. (b)**Cost of Production (As per CAS 4)**

FY 2024-25	₹ in lakhs	
	Amount (₹)	Cost per M. Ton (₹)
Cost Information		
Output 1430 MT		
Cost of Material purchased less ₹ 320 for railway demurrage charges	5302 (*1)	3.71
Material from sister concern at cost	1606 *(2)	1.12
Cost of Utilities	3628	2.54
Direct Employee cost	1450	1.01
Direct Expenses	860	0.60
Consumable Stores Spares	1425	1.00
Repairs & Maintenance (less abnormal breakdown cost of ₹ 140)	410 *(3)	0.29
Depreciation/Amortization	1280	0.90
Other Overheads	1420	0.99
Admn overheads related to cost of production	660	0.46
Working Capital Interest to Bank	Nil *(4)	Nil
WIP Adjustments	(-360)	-0.25
Misc subsidy received for Operations	(-325)	-0.23
Net Amount	17356	12.13
Packing costs	540	0.38
Total Cost of Production	17896	12.51

Note : *(1) Demurrage charges shall not form part of cost as per CAS 4

*(2) Rule 30 of CGST Rules states that cost of goods from related persons shall be 110% of cost of supplier.

*(3) Abnormal breakdown cost shall not form part of product cost.

*(4) Interest and other finance cost shall not form part of cost.

* Subsidy received is deducted from cost.

5. (a)

Chemicals And Fertilizers Ltd.,
Reconciliation of financial profit and costing profit for the year ended March 31, 2025
Amount in ₹ thousand

Profit or Loss as per Financial Accounts		87,806
A. Less: Income not considered in Cost Accounts:		
(i) Profit on sale of Fixed Assets	160	
(ii) Urea & Transport Subsidy	358	
(iii) Litigation Recovery - Prior year	135	
(iv) Favourable Exch. Rate Variation	304	
(v) Purchase Tax Refund	463	(1,420)
		86,386
B. Add: Expenses not considered in Cost Accounts		
(i) Expenses on CSR	66	
(ii) Post-retirement medical grant	594	
(iii) Own consumption (chemicals) valuation difference (392-375)	17	677
C. Less:		
Difference in Valuation of stock between Financial Accounts and Cost Accounts (9,030 - 5,770)		(3,260)
Profit as per Cost Accounts		83,803

Workings:

Amount in ₹ thousand

Current Year 2024-25:	Financial Accounts	Cost Accounts
Opening: Semi finished	32,700	36,210
Finished	84,220	79,590
Total	1,16,920	1,15,800
Closing: Semi Finished	36,720	40,120
Finished	89,230	81,450
Total	1,25,950	1,21,570
Variation in Inventory	9,030	5,770
Increase in Difference of Stock valuation towards financial accounts		3,260

5. (b)

Financial Forensics:

Financial forensics and cost accounting/cost audit are closely interrelated—they both deal with examining, validating, and interpreting financial and operational data, but with different purposes. Moreover, Financial forensics and cost accounting/audit are complementary. Cost audit is about verifying operational efficiency and cost integrity, while financial forensics uses such data to investigate and prove wrongdoing. Hence, good cost systems enable effective forensic investigations.

Financial Forensics is a field that combines accounting and investigation. One of the main purposes of financial forensics is discovering and gathering evidence of criminal activity involving money. They investigate individuals' and organisations' finances to determine the truth about how they manage them. Financial forensics professionals help prevent financial crime and recover lost assets.

In recent years, there have been considerable changes in the business landscape. The increasing globalisation, free movement of people, easy communication, technological advancements, and the shrinking of the world have helped change the business environment. These factors have led to the rapid growth of established businesses and the sprouting of new ones. However, this growth of companies has also increased in financial crimes and frauds. Many businesses keep a separate department of in-house accountants who keep an eye on all the business activities and strive to minimize any irregularities in the business's recordings. However, there are still cases of new and innovative fraudulent activities that can only be uncovered after an in-depth analysis of all the records and books of the business.

This situation has led to the growth of a niche field known as forensic accounting, which can be explained as the integration of accounting and investigative skills. To understand more about forensic accounting and the various techniques which help in uncovering any financial fraud.

Forensic Accounting/Auditing is a type of accounting that cross-checks a business's various financial records to find any indication of fraud being committed. It also provides an in-depth analysis of all the businesses financial books, which could be presented in the court of law as evidence. Forensic accountants can be considered detectives in the economic and business field. These people go through every recorded transaction and try to find any fraudulent or illegal activity within the industry.

Forensic accounting not only helps the business minimize its losses but will also help improve the efficiency of the business, ultimately leading to greater profitability. Furthermore, it can help the management keep track of the various business activities and prevent any fraud from happening in the future.

Forensic Audit Techniques:

The investigative techniques for forensic accounting:

- (i) Reviewing Public Documents and Conducting Background checks
- (ii) Conducting Detailed Interviews
- (iii) Gathering Information from Trustworthy Sources
- (iv) Analysing Evidence Gathered
- (v) Conducting Surveillance
- (vi) Going Undercover
- (vii) Analysing the Financial statements.

6. (a)

Responsibility of Enforcement Directorate:

Enforcement Directorate has been given the responsibility to enforce the provisions of the PMLA, by conducting investigation to trace the assets derived from proceeds of crime, to provisionally attach the property to ensure prosecution of the offenders and confiscation of the property by the Special Court.

Powers of Enforcement Directorate:

1. ED has powers to impose penalty on reporting entities for non-compliance with the PMLA.
2. It has the power of
 - Provisional attachment of property
 - Survey
 - Search and Seizure
 - Search persons
 - Arrest
 - Retention of property
 - Retention of Record

6. (b)

Who is qualified to Conduct Management Audit?

Management Audit is not covered by any statute in India. Hence, no qualification bar can exist. Any person, possessing certain qualities can perform management audit. Not the qualifications, but qualities are important.

The management auditor should have the following qualities:

- A management auditor should have good knowledge and experience of all Managerial Functions.
- An Auditor should have good knowledge of financial, cost statements analysis techniques.
- He who knows about economics and business laws, etc.
- Understanding of Organization structure and decisions taken by management, the working of the organization and its problems is also required.
- Thorough understanding of all processes and control aspects.
- He should know and understand the objectives of the organization very well.
- He should understand planning, budgets, rules, and procedures to be applied in management reviews.
- He should be well-versed with the entire production process.
- He should have enough knowledge and experience to understand the reason behind the lack of coordination between different departments.
- He should have the quality of giving practical and achievable solutions to the problems in the organization.

Cost Accountant, by virtue of his closer and more intimate association with the industrial environment, would be in a better position to undertake successfully the management audit.

Moreover, he is clearly associated with the entire supply chain management.

Another question that requires an answer is Whether the management audit should be conducted by independent practising cost accountant or companies own cost accountants specially charged with this responsibility?

- It is obvious that a company's own cost accountant howsoever exalted he may be, cannot act with a full sense of independence, as an external auditor will be able to do.

- But he will have an advantage over his external colleague, in that, having worked with the company, he has a better grasp over the company's activities.
- So long as the management audit is not prescribed by law, a company will have to make its own decision in this regard.

To the question-who should conduct a management audit? There can be another answer.

Instead of entrusting it entirely to a cost accountant – internal or external- we can as well think of a team consisting of – An industrial or production engineer, a social scientist, an economist and a practising/own cost accountant. This proposal has the merit that it will collect the experience and expertise under one roof and this collective wisdom will make a better job of management audit.

7. (a)

Cybersecurity is the practice of protecting computer systems, networks, and data from unauthorized access, use, disclosure, disruption, modification, for businesses, organizations, and individuals to maintain operational continuity, protect sensitive information, and prevent financial and reputational damage.

Cyber security is a professional discipline that is about creating defensive measures to protect against cyber-attacks. One important note about cyber security is that it is almost entirely about prevention.

To keep “cyber hygiene” in good condition, Cyber security encompasses many protocols that are used in the real world to protect data vital for the organization. There are the basics which will drastically improve the online safety. These cybersecurity basics apply to both individuals and organization. Examples are:

- Things like using strong passwords, updating software setting, user permissions, establishing file transfer protocols (FTP).
- Requiring secure, frequently changing passwords, turning on multi-factor authentication are all vital elements of cyber security.
- It's not just up to one individual, everyone in an organization needs to be trained for thinking before click on suspicious links, data backups, and incident management, while also considering VPNs, firewalls, and Zero Trust architecture for safe computer usage for security.

7. (b)

Capacity utilization refers to the extent a company or economy uses its productive resources (like equipment, labour, and facilities) to generate output, expressed as a percentage of potential output. It's calculated by dividing the actual output by the potential output and multiplying by 100 to express it as a percentage.

Formula: $(\text{Actual Output} / \text{Maximum possible Output}) \times 100 = \text{Capacity Utilization Rate}$.

The capacity utilization rate is an important indicator for companies because it can be used to assess operating efficiency and provides an insight into cost structure. It can be used to determine the level at which costs per unit go up or down. When there is a rise in output, the average cost of production will decrease.

It is one of the Key Performance Areas of Operational Efficiency which Management Auditor should focus on. In general terms, Capacity utilization indicates how well the resources available to the Management have been utilized. The resources may include Plant & Machinery, Building, Land, Raw Materials, Manpower, Utilities etc. Understanding capacity utilization helps businesses assess their operational efficiency, identify areas for improvement, and make informed decisions about resource allocation and investment. For Higher capacity

utilization, reduced cost of production adds to profitability. For lower capacity utilization, the reasons may be identified as to

- 1) Machine Break Down- Better maintenance required.
- 2) Loss of Market share- To focus on product quality or renovation.
- 3) Non-availability of key raw materials- To develop new vendors, alternately look for in-house material production
- 4) Non-availability of power- Arrange for captive power plant.

8. (a)

Structure of Internal Control:

There is no uniform or identical approach of internal control in all organizations. It often varies in concept and applications, having regard to the following:

- (a) Type of business
- (b) Magnitude of the business
- (c) Infrastructure available in the organization
- (d) Potentiality of human resources and their outlook.

Factors to be considered while designing an Internal Control System to ensure greater chances of a successful internal control system:

1. Segregation of duties

It is very necessary for a successful internal control system that no one person handles the complete transaction.

Similarly, the people responsible for authorizing these transactions or reconciling the records should also be different.

2. Rotation of Duties

It is also sometimes more desirable to rotate the duties of various officers and staff in an attempt to ensure that fraud or error, if any, may not remain undetected for a very long time.

3. Competence and Integrity of People

The controls to be successful and effective necessitate the need for competent people to enforce such controls.

4. Appropriate Levels of Authority

Controls to be effective require the authority to be granted on a need to have basis only.

5. Accountability

The mere presence of these controls may have no meaning or may give a false sense of security, unless strict action is taken every time, a discrepancy is noticed.

6. Adequate Resources

It is very necessary that minimum resources to enforce the controls must always be present to enable the controls to be successful and effective.

7. Supervision and Periodical updation

It is very necessary for the controls to be adequately supervised and periodically updated in line with changing environment to be effective and successful.

8. (b)

The audit program should include in a sequential order all assets, liabilities, income, and expenditure ensuring that no material item is omitted:

i) **Corpus fund:**

The contributions/grants received towards corpus be vouched with reference to the letters from the donor(s). The interest income be checked with the investment Register and physical investments in hand.

ii) **Reserves:**

Vouch transfers from projects/programmes with donors' letters and board resolutions of NGO. Also check transfers and adjustments made during the year.

iii) **Ear-marked funds:**

Check requirements of donors' institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.

iv) **Project/Agency Balances:**

Vouch disbursements and expenditures as per agreements with donors for each of the balances.

v) **Loans:**

Vouch loans with loan agreements, receipt counter-foil issued.

vi) **Fixed Assets:**

Vouch all acquisitions/sales or disposal of assets including depreciation and the authorizations for the same. Also check donor's letters/agreements for the grants. For immovable property, check title, etc.

vii) **Investments:**

Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis-investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.

viii) **Cash-in-hand:**

Physically verify the cash in hand and imprest balance, at the close of the year and whether it tallies with the books of accounts.

ix) **Bank balance:**

Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.

x) **Stock in Hand:**

Verify stock in hand and obtain certificate from the management for the quantities and valuation of the same.

xi) **Programme and Project Expenses:**

Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.

xii) **Establishment expenses:**

Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.

The receipt of income of NGO may be checked on the following lines:

i) **Contribution and Grants for projects and programmes:**

Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976

ii) **Receipts from Fund Raising programmes:**

Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.

iii) **Membership fees:**

Check fees received with membership register, ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.

iv) **Subscription:**

Check with subscription register and receipts issued. Reconcile subscription received with printing and dispatch of corresponding magazine/circulars/periodicals. Check the receipts with subscription rate schedule.

v) **Interest and Dividends:**

Check the interest and dividends received and receivable with the investments held during the year.