PAPER - 17 : COST AND MANAGEMENT AUDIT

SUGGESTED ANSWERS

SECTION – A

1. (a)

(i) (D)

(ii) (C)

(iii) (C)

(iv) (B)

(v) (C)

(vi) (C)

(vii) (C)

(viii) (C)

(ix) (B)

(x) (B)

1. (b)

(xi) (A)

(xii) (A)

(xiii) (B)

(xiv) (B)

(xv) (C)

SECTION-B

2. (a)

Definition of Cost Audit:

According to Chartered Institute of Management Accountants, London (CIMA), cost audit is "the verification of the correctness of cost accounts and of the adherence to the cost accounting plan". In other words, cost audit is the verification of the cost of production of any product, service or activity on the basis of accounts maintained by an enterprise in accordance with the accepted principles of cost accounting.

The Institute of Cost Accountants of India, defines cost audit as "a system of audit for the review, examination and appraisal of the cost accounting records and attendant information, required to be maintained by specified industries, as mandated by the applicable Companies Act and Rules framed thereunder."

Cost Audit is an independent examination of cost statements, cost records and other related information of an entity, with a view to express an opinion thereon. Standards on Cost Auditing provide guidance to the cost auditor through each step of the audit process with regard to the audit procedures to be followed; responsibilities of the cost auditor; and cost reporting. \

Scope of Cost Audit

The primary objective of 'Cost Audit' is ensuring accuracy of cost data, accumulation and exact computation of the cost of a product. However, the vast scope of Cost Audit works as a mirror of entity's performance. The tune is perfectly captured in the definition of 'Cost Audit' propagated by the professional bodies entrusted with the responsibility of regulating and monitoring Cost Audit.

Social Objectives:

(i) Verifying whether the pricing of the products is justified as per the product and quality are concerned.
(ii) Removing the disparities, if any, in the pricing of products and/or services.
(iii) Ensuring that no cost based economic imbalance occurs in product and /or services.
(iv) Facilitating the global market cost competitiveness of the products.
(v) Ensuring the efficient utilization of resources.
(vi) Providing reliable cost data for tariff fixation, subsidies, anti-dumping measures, and public procurement.

2. (b)

Finance Costs:

As per the Companies (Cost Records and Audit) Rules, 2014 and Cost Accounting Standard (CAS-17) on Interest and Financing Charges, Finance Costs should be separately identified and recorded.

(a) Finance costs are costs incurred by an enterprise in connection with the borrowing of fund or other costs which in effect represent payment for the use of non-equity fund.
(b) Finance costs incurred shall be identified for-
  (i) acquisition or construction or production of qualifying assets including fixed assets; and
  (ii) other finance costs for production of goods or operations or services rendered which cannot be classified as qualifying assets.
(c) Finance costs directly attributable to the acquisition or construction or production of a qualifying asset shall be included in the cost of the asset.
(d) Finance costs shall not include imputed costs.
(e) Subsidy or grant or incentive and any such payment received or receivable with respect to finance costs shall be reduced from the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.
(f) Penal Interest for delayed payment, fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the finance costs. In case the company delays the payment of statutory dues beyond the stipulated date, interest paid for delayed payment shall not be treated as penal interest.
(g) Interest paid for or received on investment shall not form part of the other financing charges for production of goods or operations or services rendered;
(h) Items of Finance Costs include Interest on Term Loans, Interest on Working Capital Loans, Debenture Interest, Bank Charges Related to Borrowings, Finance Charges on Lease Liabilities, Discounting Charges, Commitment Charges, Other Borrowing Costs, etc.
(i) Assignment of finance costs to the cost objects shall be based on either of the following two principles; namely: -
  1. Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost and
  2. Benefits received - to be apportioned to the various cost objects in proportion to the benefits received by them.
(j) Consistency Principle - The basis of assignment should be applied consistently from period to period.

3. (a)

Professional Misconduct in relation to Cost Accountants in Practice:

As per Part I of the First Schedule of the Cost and Works Accountants Act, 1959, 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 himself;

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 work, 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;

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 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 organisation 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 the firm subject to such guidelines as may be issued by the Council.

(8) Charges Contingent Fees: i.e. accepts fees dependent upon findings or results except where permitted by law.

3. (b)

Factors in Planning Cost Audit Assignment:

In planning the audit assignment certain important factors are taken into consideration viz.

(a) Requirement of audit personnel for the assignment
(b) Documentation of the audit procedures and of evidence
(c) Quality Control exercises over performance of the assignment etc.,

Requirement of audit personnel for the assignment:
Experience and training of audit personnel engaged for the assignment should be considered particularly keeping in view of the relevant industry. Prior practical experience of the industry helps in carrying out the study of the system and procedures in vogue.

The cost audit team to whom the assignment is to be delegated need appropriate direction and supervision. It is therefore, essential that they accomplish all the relevant tasks relating to the same.

The audit personnel should be asked to collect the documentary evidence and fill in the relevant cost audit file for future reference.

Documentation of the audit procedures and of evidence:
The cost auditor should document all matters which are important in providing evidence to support the opinion given in the report. It is important to remember that the documents may include issues beyond accounting data as other information such as production schedule, quantitative and statistical data etc. may be required for preparation of performance analysis.

The daily worksheets should include all queries raised, with whom it was discussed and how, and if they were satisfied.

Working paper management improves the productivity of the audit assignment undertaken. The essentiality is that of quick retrieval of information from the files of working papers. Working paper file contains details relating to the financial year under reference. This file should be properly indexed and divided into convenient sections.

The cost auditor and his team should adopt appropriate procedures for maintaining the confidentiality and safe custody of the working papers and for retaining them for a period sufficient to meet the needs of the practice and in accordance with legal and professional requirements of retention of records.

Quality Control over performance of the assignment:
Supervision and control involve direction, review and monitoring of the audit assignment in hand. The personnel carrying out these responsibilities generally perform the functions like monitoring progress, modify plan and programme, and review individual progress of work of Audit Assistant during course of Audit.

4. (a)

COST SHEET

	Calculation	**₹ Lakh p.m.**
Material cost		
Coal	450 mt × ₹ 26,000 per month	117.00
Oil	10 mt × ₹ 1,35,000 per month	13.50
Water	9 lakh ltr × ₹ 2.75 /ltr	24.75
Total Material Cost		155.25
Wages for Generator Plant	(120 × ₹ 34,000) + (180 × ₹ 24,000)	84.00
Wages for Boiler plant	(90 × ₹ 29,000) + (140 × ₹ 22,000)	56.90
Depreciation - Generating Plant	(150 lakh × 0.10) / 12	1.25
Depreciation- boiler plant	(80-8) / 12 = ₹ 6 lakh / 12	0.50

Repair & Maintenance of generating plant & boiler		8.00
Administrative Exp		25.00
Total Cost		330.90
Less: Sale of Ash		3.00
Net Cost		327.90

Units Flow:

a) Units generated = 160 lakh

b) Auxiliary consumption = 160×5%=8 lakh

c) Units supplied to factory = 160−8=152 lakh

Cost Per Unit Generated = ₹ 327.90 /152 lakh = ₹ 2.157

4. (b)

ABC Ltd.

Compilation of Direct Expenses (as per CAS 10)

Particulars	**Product X**	**Product Y**
Royalty paid on Sales	5,25,000	4,50,000
Add: Royalty paid on Units produced	2,50,000	1,75,000
Add: Hire charges of Equipment used in producing of product Y	Nil	75,000
Add: Design Charges	1,60,000	1,90,000
Add: Software Development charges	2,00,000	2,50,000
Direct Expenses (Total)	11,35,000	11,40,000

5. (a)

Calculation of Value Addition:

Year ended 31st March	2026	2025
	Amount in ₹ lakh	
VALUE ADDITION:		
Net Sales	4800	3840
Add: Export Incentives	-	-
Add/Less: Adjustment in Finished stocks	20	10
	4820	3850
Less: Cost of bought out input:		
i) Cost of Raw materials consumed	1760	1440
ii) Consumption of stores and spares	160	140
iii) Power & Fuel	240	192
iv) Other overheads	1,056	861
(430+36+260+20+250+60) = 1,056		
(370+30+220+16+200+25) = 861		
Total cost of bought out input:	3216	2633
VALUE ADDED	1,604	1,217

5. (b)

Corporate Frauds: Corporate fraud consists of illegal or unethical and deceptive actions committed either by a company or an individual acting in their capacity as an employee of the company. Corporate fraud schemes are often extremely complicated and, therefore, difficult to identify. It often takes an office full of forensic accountants' months to unravel a corporate fraud scheme in its entirety.

When corporate fraud is perpetrated by the top executives of a large corporation, the fraud often extends to billions of dollars in scale. The victims of corporate fraud are consumers or clients, creditors, investors, other businesses, and eventually, the company that is the source of the fraud and its employees. When it is finally discovered, the company committing the fraud is often left in ruins and forced to declare bankruptcy.

- Corporate fraud consists of illegal, deceptive actions committed either by a company or an individual who is an employee of the company.
- Many corporate fraud schemes are highly complicated accounting schemes used to inflate a company's apparent profits and may take years to detect.
- When massive corporate fraud is eventually discovered, it can take down even huge multinational companies with billions in annual revenues.

  Much of the money illegally obtained through corporate fraud is often never recovered, after being spent long ago by the perpetrators.

The major causes leading to corporate fraud in modern business organisation:

(a) **The Desire or Perceived need to attract or retain Investors:** Corporate fraud commonly occurs for the same reason as any other fraud scheme-greed. However, amid the highly competitive global business environment of the modern world, it may also occur for other reasons. Many corporate fraud schemes consist of fraudulent accounting schemes used to make a company appear more profitable than it is. The impetus behind such schemes is the desire or perceived need to attract or retain investors.

(b) **Problems or defects with a Company's Products**: Another cause of corporate fraud may be problems or defects with a company's products, which it tries to hide. Several recent corporate fraud cases have occurred with pharmaceutical companies that attempted to hide certain side effects or dangers associated with using certain medicines they manufactured and sold.

Government regulatory authorities, the Securities Exchange Board of India (SEBI) and the Securities and Exchange Commission (SEC) in the United States, use laws and regulations to try to prevent, detect and punish corporate frauds. However, fraud may go undetected for many years before it becomes apparent to authorities, especially if the guilty company is a private company that is not required to publicly disclose its financial records.

6. (a)

Objectives: Financial Intelligence Unit (FIU-IND), the national agency is responsible:

a) for receiving, processing, analysing and disseminating information relating to suspect financial transactions.

FIN-IND is also responsible for coordinating and strengthening efforts of

b) National and international intelligence

c) Investigation and enforcement agencies
In pursuing global efforts against money laundering and related crimes.

FIU-IND is an independent body that reports directly to the Economic Intelligence Council (EIC), headed by the Finance Minister of India.

Functions of FIU-IND:

(i) The main function of FIU-IND is to receive cash/suspicious transaction reports, analyse them and, as appropriate, disseminate valuable financial information to intelligence/enforcement agencies and regulatory authorities.

(ii) Collection of Information: Act as the central reception point for receiving Cash Transaction reports (CTRs), Non-Profit Organisation Transaction Report (NTRs), Cross Border Wire Transfer Reports (CBWTRs), Reports on Purchase or Sale of Immovable Property (IPRs) and Suspicious Transaction Reports (STRs) from various reporting entities.

(iii) Analysis of Information: Analyze received information in order to uncover patterns of transactions suggesting suspicion of money laundering and related crimes.

(iv) Sharing of Information: Share information with national intelligence/law enforcement agencies, national regulatory authorities and foreign Financial Intelligence Units.

(v) Act as Central Repository: Establish and maintain national database on the basis of reports received from reporting entities.

(vi) Coordination: Coordinate and strengthen collection and sharing of financial intelligence through an effective national, regional and global network to combat money laundering and related crimes.

(vii) Research and Analysis: Monitor and identify strategic key areas on money laundering trends, typologies and developments.

6. (b)

A management audit report is a formal, objective document summarizing the evaluation of an organization's leadership, policies, and operational procedures. It details whether a company's managers are efficiently utilizing resources and effectively achieving corporate goals, and provides actionable recommendations for improvement.

Unlike a traditional financial audit (which focuses strictly on accounting accuracy), a management audit assesses the overarching quality of management. Its core purpose is to identify operational bottlenecks, strategic misalignments, and leadership weaknesses.

Management Audit Report (MAR) is the reflection of the quality of review performed in various areas. It is important to prepare a good MAR. A good MAR can motivate the management and get the required results.

Characteristics of a good management audit report:

(i) Pertinence

(ii) Comprehensiveness

(iii) Brevity

(iv) Timeliness

(v) Motivating

(vi) Appropriate

(vii) Data based to support outcome

Management Audit reports are often labelled as ‘exception reporting’. The deviations from laid down processes, unauthorized activities, performance deterioration, value destruction are normally dealt with in reports. Benchmarking of activities, industry norms and practices are also highlighted as ‘scope of improvement’. Fraudulent activities, reputational risk, system and control lapses are also forming part of reports. Corrective measures are suggested to rectify the position and address management concerns. The top policy executive is generally interested in four factors in operating statements – facts, the person responsible, deviations in actual performance from standards, and the effect of the result on the financial or physical status of the organisation.

The report must allow management to study comparisons, review organisation, and appraise the effectiveness of the executives. Departmental weakness can be quickly seen by the management, if the report is properly prepared.

The management audit report should create awareness among the management of prudent management practices that can make the organisation come alive. It is a very important function of management audit to help the change management mindset.

Report discussion with management and buying in of suggestions for implementation in time bound manner improves governance and a hallmark of progressive management and Organisation.

A management audit report should also be discussed with the people concerned in various areas before reporting. Every point that is raised in the report should have the acceptance of the people involved in the concerned function. A report that indicates suggestions that had come from the people themselves would have a better than coming as a suggestion from the auditor.

The report should be drafted and structured so that it makes a logical presentation to the management and makes it easily readable. The report should contain not only the problems and defects in the working, but also should come out with solutions, as if given by the operational people themselves, so that it gains immediate acceptance for implementation. A management audit report relies heavily on accepted managerial practices and feasible solutions.

7. (a)

Corporate image is the overall perception, feelings, and reputation of a company held by the public, stakeholders, and customers. It is the "face" of an organization—how it is seen, understood, and remembered, encompassing both internal and external views. Key components include logos, branding, employee behavior, and company values.

A positive corporate image enhances the overall accessibility of the organization in all spheres of society. To build a positive image, many methods are used, to quote a few below:

i) advertising in various media and forum

ii) television is available in remotest part of the country and the use of this platform reach the stakeholders in visual form.

iii) quality products and customer service is a method which develops loyalty to the product and entity.

iv) provision of social amenities like CSR activities, community support, social bonding are helpful.

v) in situations of disaster, the support given to society are immensely helpful in building image.

vi) BCM Marketing have the knowledge and the necessary tools to make the most of the corporate image.

7. (b)

Performance Analysis:

A performance Analysis is an evaluation of how a business or individual has performed within the limited timeframe against set parameters. Any variations from projected metrics, need to be under focus to understand the next course of action to pre-empt the possibility of any future/shortcoming.

Here are some specific metrics or goals a company might consider during a performance analysis:

- Parameters against which performance to be measured
- Past parameters and measuring yardstick
- Ensuring no change in parameters and yardstick
- Measurement of actual delivery
- Assumptions used for both micro and macro conditions with impact thereon.
- Adjustment at base level for the actuals at different points of time
- Process of monitoring and review of parameters and actuals against the same
- Equal period or timeframe for evaluation and period of appraisal
- 'root cause' analysis for deviations from expected performance
- Feedback to employees on business performance improvement.

8. (a)

OBJECTIVES OF OPERATIONAL AUDIT:

Operational Audit objective has been coined here after the name of the connoisseur of TQM (Total Quality Management) W.E. Deming. To define the objective the work 'DEMING' is used, where each of the word stands for a definitive objective accomplishment.

D – Detailed understanding of existing process to suggest improvements
E – Eliminate Waste, Duplication of Work
M – Merge Operations/Processes to reduce Turn Around Time
I – Improve/Increase Quality, Volume, Revenue
N – New Methods, Techniques, Devices for better result/throughput
G – Govern Man, Machine, Methods and Money

To carry out the heightened expectations of 'stakeholders' on their shoulder, Auditors can no longer spend their time looking down at financial controls and compliances, rather to spend much more time in operational reviews.

Gone are the days of 'pushing the pencil'. 'Brain power' is taking place of 'brawn power'. To support the accomplishment of aforesaid objective, the audit process should lend appropriate support. Process provides a methodology for intelligently and efficiently integrating People, Tools, Procedures and Technology for the best results/outcome.

Advantages of Operational Audit:

- Going through the operational audit process provides a company with objective opinions. These opinions often generate quicker production by lowering TAT (Turn Around Time), pointing process inefficiencies, the location of areas of delay/tapes, cost rationalization/reduction.
- Move towards operational excellence.
- Improves efficiency and productivity.
- Enhances resource utilization.
- Identifies operational weaknesses.
- Strengthens internal control systems.
- Reduces costs and wastage.

- Improves risk management.
- Facilitates better decision-making.
- Encourages accountability and responsibility.
- Improves service quality and customer satisfaction.
- Supports achievement of organizational objectives.

Disadvantages of Operational Audit:

- Time-consuming process.
- May involve high audit costs.
- Mental fear of Resistance to change from employees and management.
- Difficult to measure qualitative aspects.
- Recommendations may not always be implemented.
- Requires skilled and experienced auditors.
- Possibility of subjective judgments.
- Can disrupt normal operations during audit activities.
- Benefits may not be immediately visible.
- Limited effectiveness if management support is lacking.

8. (b)

AUDIT OF HOSPITALS:

The following points are to be considered necessary for conducting an audit of Hospital.

(i) Check the letter of appointment to ascertain the scope of responsibilities.

(ii) Ownership and control of the institution.

(iii) Process (e.g. admission, release, outdoor check-up, pathology and other test facilities, Operation Theatre facility, vaccination etc.) and related controls till revenue generation. Normally facilities not provided for other than cash terms.

(iv) Donation, Special Grant, Interest and/or dividend income etc. to be validated through necessary supporting documents. E.g. Dividend/ Interest Income should be vouched with reference to the Investment Register and Interest and Dividend Warrants.

(v) Ensure that purposive donations, grants etc. spent for the particular purpose only.

(vi) Clear distinction should be made between the items of capital and revenue nature.

(vii) Adherence to Standard Operating Procedure w.r.t. Expenses (Capex and Opex).

(viii) verify the system of internal check as regards purchases and issue of stores, medicines, medical equipment, etc.

(ix) Examine the appointments of the staff, visiting specialist doctors, payment of salaries etc. for expenditure, booking validation.

(x) Physically verify the investments, fixed assets and inventories.

(xi) Check appropriateness of capitalization and depreciation rates charged and value in books.