FINAL EXAMINATION

MODEL ANSWERS

PAPER – 17

COST AND MANAGEMENT AUDIT

SET - 1

TERM – DECEMBER 2025

SYLLABUS 2022

Time Allowed: 3 Hours **Full Marks: 100**

The figures in the margin on the right side indicate full marks.

SECTION – A (Compulsory)

1) Choose the correct option: **[15 × 2=30]**

(a)

(i) The report on the audit of cost records is submitted by the cost auditor to_____.

a) Managing Director
b) Finance Director
c) Audit Committee
d) Board of Directors

(ii) Which one of the below is not a regulated industry?

a) Telecommunication
b) Automobile
c) Electricity
d) Drugs & Pharmaceuticals

(iii) A cost accountant who fails comply with the provisions of sub-section (12) of Sec. 143 of the Companies Act, 2013, shall be punishable with fine of maximum ₹_____.

a) ₹5.00 lakhs
b) ₹25.00 lakhs
c) ₹1.00 lakhs
d) ₹10.00 lakhs

(iv) Cost Audit Report is to be filed on MCA Portal within ______ days from the end of FY to which The Cost Audit pertains

a) 100
b) 120
c) 180
d) 250

(v) Objective of Cost Auditing Standard _____ is to guide members in planning for the audit of Cost Statements.

a) 101
b) 102
c) 103
d) 104

(vi) Which of the following is not listed as a key task of audit personnel in planning a cost audit assignment?

a) Physical inspection of the activities and the area where they are performed.
b) Knowledge of the key personnel responsible for the activities and maintenance of cost records.
c) Study of the statements of budgets, plans, and strategies relating to activities.
d) Preparation of the company's financial statements for statutory audit.

(vii) **Which of the following best describes an Adverse Audit Report on cost accounting records and cost statements of a company?**

a) **It confirms that the cost statements are free from material misstatements and conform to accepted accounting principles.**

b) **It indicates that the cost statements are materially misstated, unreliable, and do not conform to generally accepted cost accounting principles.**

c) **It suggests that the cost statements contain minor errors that do not affect the overall reliability of financial information.**

d) **It provides a clean opinion stating that the company's operational results can be assessed accurately.**

(viii) **Internal controls and internal checks are:**

a) **One and the same.**

b) **Different.**

c) **Internal control includes internal checks.**

d) **None of the above.**

(ix) **Who can be appointed as Internal Auditor as per the Companies Act, 2013**

a) **A Chartered Accountant**

b) **A Cost Accountant**

c) **Such other professional**

d) **All of the above**

(x) **A model categorizing known frauds which lists about 49 different individual fraud schemes grouped by categories and subcategories is known as __________.**

a) **Fraud triangle.**

b) **Fraud square.**

c) **Fraud model.**

d) **Fraud tree.**

(b) **Following data available from product wise profitability statement**

Particulars	₹ Per Unit
Sale	100000
Raw Material	50000
Utilities	15000
Packing Material	5000
Employee Cost	5000
Consumable Stores	4000
Repair Expenses	3000
Depreciation	5000
Insurance	1000
Overheads	2000

Answer the following five questions based on the above case study

(i) What is the variable cost of the product
- a) ₹50,000 Per Unit of Finished Product
- b) ₹60,000 Per Unit of Finished Product
- c) ₹70,000 Per Unit of Finished Product
- d) ₹80,000 Per Unit of Finished Product

(ii) What is the Fixed cost of the product
- a) ₹10,000 Per Unit of Finished Product
- b) ₹20,000 Per Unit of Finished Product
- c) ₹25,000 Per Unit of Finished Product
- d) ₹30,000 Per Unit of Finished Product

(iii) What is the Contribution of the product
- a) ₹10,000 Per Unit of Finished Product
- b) ₹20,000 Per Unit of Finished Product
- c) ₹25,000 Per Unit of Finished Product
- d) ₹30,000 Per Unit of Finished Product

(iv) What is the Profitability of the product
- a) ₹10,000 Per Unit of Finished Product
- b) ₹20,000 Per Unit of Finished Product
- c) ₹25,000 Per Unit of Finished Product
- d) ₹30,000 Per Unit of Finished Product

(v) What is Raw Material Cost as % of Total Cost
- a) 54.56
- b) 55.56
- c) 56.56
- d) 57.56

Answer:

(a)

(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)	(x)
d	b	b	c	a	d	b	c	d	d

(b)

(i)	(ii)	(iii)	(iv)	(v)
c	b	d	a	b

SECTION – B

Answer any 5 questions out of 7 questions given. Each question carries 14 marks. [5 × 14 = 70]

2) (a) Explain the objectives of cost audit. [7]

(b) Explain the provisions relating to Applicability for Cost Audit as per Companies (Cost Records and Audit) Rules, 2014. [7]

Answer:

(a) Cost Audit has both general and social objectives.

General Objectives:

- 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.
- Ensuring that prescribed procedures of the cost accounting records rules are duly adhered to.
- Detection of errors and fraud.
- Verification of the cost of each "cost unit" and "cost center" to ensure that these have been properly ascertained.
- Determination of inventory valuation.
- Facilitating the fixation of prices of goods and services.
- Periodical reconciliation between cost accounts and financial accounts.
- Ensuring optimum utilization of human, physical and financial resources of the enterprise.
- Detection and correction of abnormal loss of material and time
- Advising management, on the basis of inter-unit/inter-firm comparison of cost records, as regards the areas where performance calls for improvement.
- Promoting corporate governance through various operational disclosures to the directors.
- 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.

Socials Objectives:

- Verifying whether the pricing of the products are justified as per the product and quality are concerned,
- Removing the disparities, if any, in the pricing of products and/or services.
- Looking into that no cost based economic imbalance may occur in product and /or services.
- Facilitating in the global market cost competitiveness of the products.
- Ensuring the efficient utilization of resources.

(b) Applicability for Cost Audit

- Every company specified in item (A) of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees fifty crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees twenty-five crore or more.
- Every company specified in item (B) of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees one hundred crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees thirty-five crore or more.

- The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3; and
  - (i) whose revenue from exports, in foreign exchange, exceeds seventy-five per cent of its total revenue; or
  - (ii) which is operating from a special economic zone;
  - (iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005.

3) (a) Discuss the eligibility criteria for the appointment of a cost auditor under Section 141 of the Companies Act, 2013 (as read with Rule 10 of the Companies (Audit and Auditors) Rules, 2014) and Section 148 of the Companies Act, 2013. [7]

(b) Classify the key factors that must be considered when planning a cost audit assignment. [7]

Answer:

(a) 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:

(i) A body corporate. However, a Limited Liability Partnership registered under the Limited Liability Partnership Act, 2008 can be appointed. [Section 141(3)(a)]

(ii) An officer or employee of the Company. [Section 141(3)(b)]

(iii) A person who is a partner, or who is in the employment of an officer or employee of the company. [Section 141(3)(c)]

(iv) 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 company or a subsidiary of such holding company. [Section 141(3)(d)(i)]

(v) Relatives of any partner of the firm holding any security of or interest in the company of face value exceeding ₹1 lakh. [Section 141(3)(d)(i) and Rule 10(1) of Companies (Audit and Auditors) Rules, 2014]

(vi) A person who or whose relative or partner 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 ₹5 lakhs. [Section 141(3)(d)(ii) and Rule 10(2) of Companies (Audit and Auditors) Rules, 2014]

(vii) A person who or whose relative or partner 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 ₹1 Lakh. [Section 141(3)(d)(iii) and Rule 10(3) of Companies (Audit and Auditors) Rules, 2014]

(viii) 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]

(ix) 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)]

(x) 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 an auditor of more than twenty companies. [Section 141(3)(g)]

(xi) 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)]

(xii) Any person whose subsidiary or associate company or any other form of entity, is engaged as on date of appointment in providing specialised services to the company and its subsidiary companies as below:

- Accounting and book keeping services
- Internal audit
- Design and implementation of any financial information system
- Actuarial services
- Investment advisory services
- Investment banking services
- Rendering of outsourced financial services
- Management services
- Any other kind of services as may be prescribed [Section 141(3)(i) and Section 144]

(b) 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 evidences

(c) Quality control exercised over performance of the assignment etc.

Audit personnel for the assignment

Experience and training of audit personnel engaged for the assignment should be considered particularly keeping in view the relevant industry. Prior practical experience of the industry helps in carrying out the study of the system and procedures in vogue. For this purpose, two pronged approaches may be adopted by the cost auditors. First, a study of the industry and the second, study of the Annual Reports of the auditee company for the past at least 5 years.

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

(i) Physical inspection of the activities and the area where they are performed;

(ii) Knowledge of the key personnel responsible for the activities and for the maintenance of cost records;

(iii) Physical inspection of the cost accounting records and other records relating to activities;

(iv) Study of the statements of budgets, plans and strategies relating to activities;

(v) Study of the Cost Accounting system used and the basis according to relevant CAS.

The audit personnel should be asked to collect the documentary evidences for the above tasks and file in the relevant cost audit file for future reference.

Documentation of the audit procedures and of evidences

The cost auditor should document all matters which are important in providing evidence to support the opinion given in the report. Documentation means the working papers prepared by and for, or obtained and retained by the cost auditor in connection with the performance of the audit or compliance function. Working papers record the evidence resulting from the work performed, to support the cost auditors' opinion. 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 it was discussed and how, and if they were satisfied. Use of standardised working papers such as, checklists, confirmation forms, standard letters etc. may improve the efficiency with which such working papers are prepared and reviewed. Schedules, statements, analyses and other documents prepared by the entity may be utilised and treated a part of the working papers, only after being satisfied that the materials have been properly prepared with due care.

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 involves direction, review and monitoring of the audit assignment in hand. The personnel carrying out these responsibilities generally perform the following functions during the course of audit.

(a) Monitoring the progress of the preparation / maintenance of cost accounting records;

(b) Reviewing that the audit assistants do have necessary skill and competence to understand the system and procedure to carry out the assigned tasks as per the overall plan;

(c) Being aware of the cost accounting and auditing questions raised during carrying out of the assignment and assessing their significance and modifying the plan and programme, as considered necessary; and

(d) Removing the differences of professional judgement between the personnel and deciding the level which is appropriate for reference purpose.

4) (a) **Purchase of Materials ₹3,00,000 (inclusive of GST of ₹15,715); Free on Board ₹12,000; Import Duty paid ₹15,000; Freight inward ₹20,000; Insurance paid for import by sea ₹10,000; Rebates allowed ₹4,000; Cash discount ₹3,000; Subsidy received from the Government for importation of these materials ₹20,000. Calculate the landed cost of material (i.e. value of receipt of material).** **[7]**

(b) **A Steel Company which produces Iron Casting Pipes and rod iron is covered under the Cost Audit according to the Companies (Cost Records and Audit) Rules 2014. From the expenditure data relating to 2024-25, calculate the employees cost according to CAS -7.**

₹in Lakh

(i)	**Salary, wages and other allowances**	**750**
(ii)	**Bonus**	**100**
(iii)	**Contribution to Providend Fund**	**90**
(iv)	**Wages to contractors employees**	**100**
(v)	**Employees welfare**	**40**
(vi)	**Abnormal cost due to strike**	**80**
(vii)	**VRS payment for closure of Rod Iron section of the plant**	**62**
(viii)	**Arear Salary (2023-24)**	**210**
(ix)	**Compensation paid against the past periods against Court order**	**67**

[7]

Answer:

(a) Computation of Material Cost Sheet

	Particulars	**Amount (₹)**
	Purchase price of Material	3,00,000
Add:	Free 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.

(b) The following items will not be included according to CAS-7:

(i) VRS paid for closure of a unit

(ii) Abnormal cost charges to Profit and Loss A/C

(iii) Area salary not related to the current year

(iv) Compensation paid against past periods

(v) Wages paid to contractor employees.

[As per explanation (1) of CAS-7 under para-4.7: Contract employees include employees directly engaged by the employer on contract basis but does not include employees of any contractor engaged in the organisation.]

Thus, employees cost:

		₹in lakh
(i)	Salary and wages	750
(ii)	Contribution to PF	90
(iii)	Employees welfare	40
(iv)	Bonus	100
	Total	980

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

Year ended 31st March	**2025**	**2024**
	(Amount in ₹lakh)	
Net Sales	**4,800**	**3,840**
Other Income	**300**	**200**
Increase in Value of Stock of Finished Goods	**20**	**10**
Raw materials Consumed	**1,760**	**1,440**
Direct wages, Salaries, Bonus, Gratuity etc.	**440**	**352**
Power & Fuel	**240**	**192**
Stores and Spares	**160**	**140**
Cess and local Taxes	**120**	**100**
Other manufacturing Overheads	**430**	**370**
Administrative Overheads:		
Audit fees	**36**	**30**
Salaries & Commission to Directors	**48**	**40**
Other Overheads	**260**	**220**
Selling and Distribution Overheads:		

Salaries & Wages	**36**	**30**
Packing and Forwarding	**20**	**16**
Other Overheads	**250**	**200**
Total Depreciation	**120**	**120**
Interest Charges:		
On Working Capital Loans from Bank	**60**	**25**
On Fixed Loans from IDBI	**90**	**70**
On Debentures	**30**	**30**
Provision for Taxes	**316**	**200**
Proposed Dividends	**420**	**230**

You are required to calculate the following parameters as stipulated PART-D, PARA-3 of the Annexure to Cost Audit Report under the Companies (Cost Records and Audit) Rules, 2014 for the year ended March 31, 2025 and March 31, 2024:

(i) Value Addition

(ii) Earnings available for Distribution

(iii) Distribution of Earnings to the different claimants. **[7]**

(b) Discuss the primary reasons why corporate fraud occurs, using relevant corporate case studies to support your answer. **[7]**

Answer:

(a)

Sinjini Ltd.
Calculation of Value Addition

	2025	2024
Year ended March 31,		
VALUE ADDITION:		
Net Sales	4,800	3,840
Add: Export Incentives	-	-
Add/Less: Adjustment in Finished stocks	20	10
	4,820	3,850
Less: Cost of bought out input:		
(i) Cost of Raw materials consumed	1,760	1,440
(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 bought out input	3,216	2,633
(i) VALUE ADDED	1,604	1,217
Add: Other Income	300	200
(ii) Earnings Available for distribution	1,904	1,417
(iii) Distribution of earnings to:		
(a) Employees as salaries and wages, bonus, gratuity etc.	476	382
Directors- Salaries and Commission	48	40

(b) Shareholders as dividend	420	230
(c) Company as retained funds (including depreciation)	404	365
(d) Government as taxes		
Local Taxes:	120	100
Income Taxes	316 436	200 300
(e) Providers of Capital/Fund as Interest on Debentures		
Interest on debentures	30	30
Interest on Fixed loans from IDBI	90 120	70 100
Total distribution of earnings	1,904	1,417

Working of Retained Earnings:

	₹in lakhs
Earning Available for Distribution	1904
Employee Cost	– 476
Directors Salaries & Commission	– 48
Dividend	– 420
Taxes	– 436
Interest	– 120
	404

(b) Corporate Frauds Happens due to the following reasons:

- **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.
- **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.

Major Corporate Fraud Cases in the World: Due to the rise of so many large, multinational corporations and conglomerates, almost all of the largest corporate fraud cases have occurred within the past five decades. The following are some of the biggest incidences of corporate fraud on record:

(i) **Enron Company:** One of the most notorious cases of corporate fraud is the Enron scandal. At its height, Enron, a major energy company, was raking in billions upon billions in profits. However, when the company began to face declining revenues and debt troubles, company executives hid the facts through massive accounting fraud. In the end, both Enron and its accounting firm, Arthur Andersen, went under. Thousands of employees lost their jobs, and Enron's creditors and investors lost billions.

The Enron Accounting scandal is credited with resulting in the passage of the Sarbanes-Oxley Act, which required more transparency in companies' financial reporting and imposed significantly harsher penalties on any company caught for committing accounting fraud.

(ii) **Waste Management:** Waste Management, the largest garbage and recyclables collector in the United States, appeared to be one of the most financially sound companies in the United States in the early 1990s. Investors eagerly bought up the company's stock, driving its price steadily higher.

However, when a New Chief Executive Officer (CEO) assumed the post in 1998, he eventually discovered that, like Enron, Waste Management previously perpetrated a multi-billion-dollar accounting fraud in an attempt to pump up its profitability numbers.

Unlike Enron, Waste Management was able, under its new leadership, to survive the resulting scandal, penalties from the Securities and Exchange Commission (SEC), USA, and a multi-million-dollar lawsuit by investors.

(iii) **ZZZZ Best Company:** The story of ZZZZ Best, a carpet cleaning company founded by a 15-year-old, is a rags-to-riches-to-rags story. Within six years of the company's founding, its entrepreneur owner was able to take the company public, with a valuation of approximately $300 million. There was just one problem- Barry Minkow, the founder, and owner of ZZZZ Best had made up out of thin air practically all of the company's alleged "Customers".

Minkow was keeping the company afloat by using money acquired from new investors to pay off previous investors. In short, engaging in a classic Ponzi scheme. Before Minkow could generate enough business to cover his fraud tracks and hopefully right the company's finances, his fraud scheme was discovered.

The result was that ZZZZ Best, once an inspiring success story, went completely burst just a few months after the Company's initial public offering (IPO).

(iv) **Wirecard Company:** One of the more recent corporate fraud cases is that of Wirecard, a payment transfer and processing company in Germany. In early 2020, accounting auditors discovered a whopping $2 billion discrepancy between the company's books and the actual money it held.

Like many corporate fraud schemes, Wirecard's cooking of its books had been going on for several years before it was detected. Wirecard was forced to declare bankruptcy, and its CEO was arrested by German authorities.

(v) **Wells Fargo & Company:** The fraud case of Wells Fargo revealed the danger of companies putting high-pressure sales quotas on employees. The result of such a practice at Wells Fargo Bank led hundreds of its employees to open fake accounts for Wells Fargo clients.

Short-term profits went up by millions, but when the widespread fraud was uncovered, the bank's fine imposed by the Securities and Exchange (SEC) ran into the billions. In addition, the bank lost hundreds, if not thousands, of clients.

6) (a) Discuss the FATF recommendations concerning terrorist financing and proliferation financing. [7]

(b) Identify the Qualities of a Management Auditor. [7]

Answer:

(a) FATF recommendations concerning terrorist financing and proliferation financing:

1. Terrorist financing offence:

Countries should criminalize terrorist financing based on the Terrorist Financing Convention and should criminalize not only the financing of terrorist acts but also the financing of terrorist organisations and individual terrorists even in the absence of a link to a specific terrorist act or acts. Countries should ensure that such offences are designated as money laundering predicate offences.

2. **Targeted financial sanctions related to terrorism and terrorist financing:**
Countries should implement targeted financial sanctions regimes to comply with United Nations Security Council resolutions relating to the prevention and suppression of terrorism and terrorist financing. The resolutions require countries to freeze without delay the funds or other assets of and to ensure that no funds or other assets are made available, directly or indirectly, to or for the benefit of, any person or entity either (i) designated by, or under the authority of, the United Nations Security Council under Chapter VII of the Charter of the United Nations, including by resolution 1267 (1999) and its successor resolutions; or (ii) designated by that country under resolution 1373 (2001).

3. **Targeted financial sanctions related to proliferation:**
Countries should implement targeted financial sanctions to comply with United Nations Security Council resolutions relating to the prevention, suppression, and disruption of the proliferation of weapons of mass destruction and its financing. These resolutions require countries to freeze without delay the funds or other assets of and to ensure that no funds and other assets are made available, directly or indirectly, to or for the benefit of, any person or entity designated by, or under the authority of, the United Nations Security Council under Chapter VII of the Charter of the United Nations.

4. **Non-profit organisations:**
Countries should review the adequacy of laws and regulations that relate to non-profit organisations that the country has identified as being vulnerable to terrorist financing abuse. Countries should apply focused and proportionate measures, in line with the risk-based approach, to such non-profit organisations to protect them from terrorist financing abuse, including:
(a) By terrorist organisations posing as legitimate entities;
(b) By exploiting legitimate entities as conduits for terrorist financing, including to escape asset-freezing measures; and
(c) By concealing or obscuring the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.

(b) 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.
- She/he should know about economics and business laws, etc.
- Understanding of Organisation 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.
- She/he should know and understand the objectives of the organisation very well.
- She/he should understand planning, budgets, rules, and procedures to be applied in management reviews.
- She/he should be well-versed with the entire production process.
- She/he should have enough knowledge and experience to understand the reason behind the lack of coordination between different departments.
- She/he should have the quality of giving practical and achievable solutions to the problems in the organisation.

7) (a) Discuss the key steps of the Information Systems (IS) Audit Methodology and explain the significance of each step. [7]

(b) Discuss the approaches for Developing Manpower Planning. [7]

Answers:

(a) Audit Methodology:

The IS audit work includes manual procedures, computer-assisted procedures, and fully automated procedures, depending on whether it is around, though, with, or a combination of all these types of audits. In many cases, a combination of these techniques is required. The IS auditors may utilize the manual procedures when they are more effective than the other alternatives or when these procedures cannot be partially or fully automated. He/she should also use computer-assisted procedures known as Computer Assisted Audit Tools (CAATs) because they permit the IS auditors to switch from the procedures based on limited, random, and statistical samples of records in a file to a procedure that includes every record in a file.

Audit activity is broadly divided into 5 major steps for the convenience and effective conduct of the audit.

(i) Planning IS Audit.
(ii) Tests of Controls.
(iii) Tests of Transactions.
(iv) Tests of Balances.
(v) Completion of Audit.

(i) **Planning IS audit:**

Planning is the first step of the IS audit. IS auditors should plan the audit work in a manner appropriate for meeting the audit objectives. As a part of the planning process, IS auditors should obtain an understanding of the auditee department/ office/organisation and its processes. It includes an understanding of the objectives to be accomplished in the audit, collecting background information, assigning appropriate staff keeping in mind skills, aptitude, etc., and identifying the areas of risk. Risk analysis of the operating system is carried out to identify the system with the highest risks, considering the critical nature of the information processed through such system as well as the number and the value of the transactions processed. This is to identify the systems having the highest risk and to decide on the extent of the detailed analysis and testing to be conducted on those systems.

In this phase, IS auditors are required to understand the internal controls used within an organisation. Various techniques can be used to understand the internal controls viz. review of previous audit reports/papers, interview/ interaction with the management and Information Systems personnel, observation of activities carried out within the Information Systems function, and review of Information Systems documentation.

(ii) **Tests of Controls:**

During this phase of IS audit, Internal Controls are tested to evaluate whether they operate effectively. This includes testing of management controls and application controls. The objective is to evaluate the reliability of the controls and find out weaknesses of the controls for meeting the IS audit objectives. IS auditor is required to make recommendations to rectify the weaknesses, observed during an IS audit.

While carrying out tests of controls, the IS auditors should satisfy themselves regarding the following aspects of controls.

- Identification: Organisation should identify the controls to minimize the occurrence of unlawful events.
- Implementation: Identified controls should be implemented.
- Existence: Sometimes it happens that controls have been implemented, but in reality, they do not exist due to various reasons. For example, the organisation may have stipulated that the users should change their passwords every week. But, in reality, this may not be happening. The physical existence of the controls is equally important.

- Adequacy: IS auditors should examine the adequacy of the controls. They should see that the controls are adequate to cover all possible threats.
- Documentation: All controls should be documented to make them effective.
- Maintenance: Controls should be maintained intact continuously. For example, only the provision and installation of the fire extinguishers, smoke detectors, UPS, etc. do not solve the problem. These instruments should be properly maintained, so that they serve the purpose, as and when needed.
- Monitoring: Controls should be monitored using strict supervision, surprise checks, periodic inspection, etc.

(iii) **Tests of Transactions:**

Tests of Transactions are used to evaluate whether erroneous transactions have led to a material misstatement of the financial information and whether the transactions have been handled effectively and efficiently. The objective is to evaluate data integrity. Some of such tests include the tracing of journal entries to their source documents, the examination of the price files, the testing of computational accuracy, the study of the transaction log, etc. These tests are used to indicate the database system's effectiveness. CAATs are quite useful to perform these tests.

(iv) **Tests of Balances:**

During this phase of IS audit, final judgment is made on the extent of the losses or account misstatement that occur when Information Systems fail to safeguard assets, maintain data integrity and achieve system effectiveness and efficiency goals. As regards the safeguarding of assets and data integrity objectives, the typical substantive tests used are confirmation of the receivables, physical verification of inventory, and recalculation of depreciation on the fixed assets. Regarding the system effectiveness and system efficiency objectives, the tests to be conducted are in the process of evolution. For example, the shortcomings in the Information Systems Planning may have resulted in the purchase of inappropriate hardware. The system may provide outputs, but not of the required standards to make high-quality decisions. During this phase of the IS audit, computer support is often required. General Audit Software can be used to select and print confirmations; expert systems can be used to estimate the likely bad debts and so on.

(v) **Completion of Audit:**

This is the final stage of IS audit. Auditors are required to form their opinion, clearly indicating their findings, analysis, and recommendations. Potential IS audit findings should be discussed with the appropriate/authorized personnel throughout IS auditing. Preliminary conclusions and the audit findings should be presented to the auditee during an exit conference. All potential findings with sufficient merits and preliminary audit recommendations should be included for discussion in the exit conference. The exit meeting should document and include the auditee's comments and questions concerning the preliminary IS audit recommendations. The draft audit report should be the natural extension of the exit conference materials along with the discussions that took place during the exit meeting. Once the auditee's responses have been received, the final audit report should be prepared and submitted to the designated authority/ management of the organisation.

Work papers used in the auditing should be well organized, clearly written, and address all the areas included in IS audit. IS audit work papers should contain sufficient evidence/information of the tasks performed and the conclusions reached, including the results achieved, issues identified, and authorized signatures approving the final opinion.

A typical audit report will include, among others, an introduction to the audit objectives, scope, general approach employed, a summary of the critical findings, the data to support the critical findings, potential consequences of the weaknesses, auditee's responses, and recommendations to rectify the weaknesses.

(b) Approaches for Developing Manpower Planning:

1. Planning for the Status Quo:

Planning involves steps to replace any employees who are either promoted or who leave the firm. An example is management succession planning which seeks to ensure that there is at least one qualified manager to replace any higher-level manager in the organisation.

2. Thumb Rule:

This is based on the firm's beliefs about forecasting human resource needs. For example, one firm believes that a ratio of one production supervisor for every 12 workmen is optimal. This firm maintains this 1:12 ratio because it has proved successful in the past. Another thumb rule is based on experience that one person can produce 2000 units of output per day and accordingly 5 employees are needed for 10,000 units as a matter of forecast.

3. Markov Analysis (MA):

Markov chains are a powerful analysis technique that, used in manpower planning, can help it successfully achieve its goal. Markov chains make it possible to predict the size of manpower per category as well as transitions occurring within a given period in the future (resignation, dismissal, retirement, death, etc.). More importantly yet, with a Markov chain, one can obtain long-term average probabilities or equilibrium probabilities.

However, to predict manpower supply and demand with accuracy using a macroeconomic model, one needs a vast array of data for each of the many variables used. To collect these data, one must first get hold of sufficiently broad-ranging time-series data for each industry. For this reason, a method of this type proves to be inadaptable for emerging sectors undergoing fast-paced growth with only small amounts of statistical data on the industry as a whole and manpower available.

4. Unit Forecasting:

This refers to the estimate of supervisors and managers about forecasting Human resource needs for the next year unit-wise – this approach is called the "Bottom-up approach" for forecasting as the selections are made by lower-level management and added together at a higher level of the organisation.

5. Ratio Trend Analysis:

The basic principle here is to say if it takes six people, for example, to perform an existing amount of work, it will take twelve people to do twice as much. Organisations measure activity levels in a variety of different ways. The ratio between 'direct' and 'indirect' in manufacturing is a classic one.

Individual departments in an organisation will also have their rule-of-thumb measures. A sales department, for instance, may have an idea of the number of customer calls a salesperson should make in a week, and, indeed, use this as one criterion for monitoring sales efficiency. If the business plan projects an increase in the number of new customers, this can be translated into a proportionate increase in the sales force.

6. Delphi Method:

This method relies on expert opinion in making long-range forecasts-this involves obtaining independent judgments from a panel of experts usually through a questionnaire or interview schedule on certain issues affecting the nature and magnitude of demand for an organisation's products and services.

7. Computer Simulation:

This is one of the most sophisticated methods of forecasting human resource needs. A computer is a mathematical representation of major organisational processes, policies, and human resource movement through organisation-computer simulations are useful in forecasting for human resources by pinpointing any combination of organisational and environmental variables.

8. Time and Motion Study:

Here the Industrial Engineer observes records and movement of workman and productivity vis-a-vis time required to conduct specific activities.

9. Most-Maynard Operation Sequence Technique:

This method is well accepted in automobile industries where lots of manual activities are involved. It is based on the walking and moving of the workmen to conduct the specific activity.

MOST is an acronym for Maynard Operation Sequence Technique. It was developed at H.B. Maynard and Co. Inc., the USA in the 1970s. It is a revolutionary PMTS System. MOST is an activity-based work measurement system that enables us to calculate the length of time required to perform a task i.e., a system to measure work. This technique is based on fundamental statistical principles and basic work measurement data compiled over many years. MOST concentrates on the movement of objects.

It was noticed that the movement of objects follows certain consistently repeating patterns, such as reach, grasp, move, and position of the object. These patterns were identified and arranged as a sequence of events followed in moving an object. This concept provides the basis for the MOST Sequence models.

8) (a) Discuss the scope of internal control. [7]

(b) Identify the key steps involved in conducting an audit of an educational institution. [7]

Answer:

(a) Internal control is an essential pre-requisite for efficient and effective management of any organisation and is therefore, a fundamental ingredient for the successful operation of the business in modern days. In fact, an effective internal control system is a critical success factor for any organisation in the long term. They are indispensable tools for the ever-increasing risks, exposures, and threats to accounting systems, data, and assets. It embraces the whole system of controls – financial, operational or otherwise, established by the management in the functioning of a business including internal check, internal audit and other forms of control. In fact, internal control has now been recognized as fundamental and indispensable to modern auditing. Thus, internal control has its all-embracing nature and is concerned with the control's operative in every area of corporate activity as well as with the way in which individual controls interrelate.

The scope of internal control, according to the aforesaid definitions, extends well beyond accounting control. Thus, the latest definition of internal control encompasses operational controls like quality control, work standards, budgetary control, periodic reporting, policy appraisals, quantitative control, etc., as all parts of the internal control system. In an independent financial audit or the statutory audit, the auditor is concerned mainly with the financial and accounting controls. However, in an operational audit (as part of internal controls), the auditor reviews all the controls including operational functions. The internal controls can be broadly classified into following four main categories: financial & accounting controls, administrative controls, operational controls and compliance controls.

(i) **Administrative Control:** Administrative controls include all types of managerial controls related to the decision-making process. An example of administrative controls is the maintenance of records giving details of customers contacted by the salesmen.

(ii) **Operational Control:** This is exercised through "management accounting" techniques viz. budgetary control, standard costing etc.

(iii) **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, accuracy and completeness of accounting records, and timely preparation of reliable financial information.

(iv) **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.

(b) The special steps involved in the audit of an educational institution are the following:

(i) Documents relating to formation of the institution, affiliation, Management structure, Governing Body, ownership etc. requires due attention for fund monitoring, donation, spent approval process, affiliation fees payment etc.

Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

(ii) Approving authority for expense, fund transfer, bank account operation etc. Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, especially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

(iii) Semester / Class-wise Student Register with details of Student name, address, Aadhar No./Card, Guardian details, Contact No. etc. and fee structure (full fees, half fees, sanctioned waiver etc.) mapped for ensuring accuracy of collection. Where collection through direct Banking takes place, the Bank Statement to be equivated with 'fees receivable/recoverable' for completeness check and proper revenue /collection (advance/ arrear) recognition. Fees collected and Fees Book counterfoil reconciliation also can be carried out, for fees collected at the Counter. Collection against every student, whose names are appearing in the 'Student Register' to be validated and unpaid ones to be followed-up.

(iv) Updation of 'Student Register' w.r.t discontinued, transferred students, drop-outs etc. to be carried out on timely basis.

(v) Fees condonation by appropriate authority to be considered for reconciliation between receivable fees and received.

(vi) Admission and other collections (late fees, transfer charges etc.) need to be tracked for separately and booked under appropriate Account Heads.

(vii) Confirm that hostel dues were recovered before students' accounts were closed and their caution deposits appropriately adjusted/refunded.

(viii) Verify other sources of income (rental income from landed property with the rent rolls, bank Fixed Deposit interest from Deposit Certificates etc.)

(ix) Grants received with the relevant papers of grant.

(x) Appropriate account head for Grant receipt and spent eligible thereunder to be checked for compliance.

(xi) Review of Receipts and Payments, Income and Expenditure for completeness and accuracy of Fund balances and bank balances.

(xii) Completeness and accuracy of income and expenditure need to be ensured.

(xiii) All statutory deposits P.F, Municipal /Corporation Taxes, Affiliation Fees etc.), filing to be checked for compliance.

(xiv) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.

(xv) Vouch in the usual manner all establishment expenses, approvals and enquire into any high volume expenditure.

(xvi) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. against the spent booked for the period under review and physical existence. These should be checked by reference to Stock Register and values applied to various items should also be test checked.

(xvii) Appropriate Fund Accounts are maintained to verify dedicated Bank balance tallies with the books maintained by the Organization.