



FINAL EXAMINATION
MODEL ANSWERS
PAPER – 17
COST AND MANAGEMENT AUDIT

SET - 2
TERM – JUNE 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. (a) Choose the correct option: [15 x 2 = 30]
- (i) Cost Audit represents true and fair view of the _____ of any product.
- A. Cost of sale
 - B. Cost of raw material consumption
 - C. Cost of production
 - D. None of these
- (ii) 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
- (iii) Which of the following type of Electricity Company is under the purview of regulated sector?
- A. Engaged in Generation
 - B. Engaged in Transmission
 - C. Engaged in Distribution & Supply
 - D. All the above
- (iv) As per Part D, Para 4 of the Companies (Cost Records and Audit) Rules, 2014, Value Addition and Distribution of Earnings are to be computed based on _____.
- A. Audited Financial Data
 - B. Cost Record Data
 - C. Unaudited Financial Data
 - D. Both (A) and (B)
- (v) Sugar and Industrial Alcohol' belong to _____ sector for the purpose of Application of Cost Records.
- A. Regulated
 - B. Non-Regulated
 - C. Both depending on circumstances
 - D. None of above



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- (vi) Relatives of any partner of the firm holding any security of or interest in the company of face value exceeding _____ lakh can not be appointed as the Cost Auditor of that company.
- A. One
 - B. Two
 - C. Three
 - D. None of the above
- (vii) CAS 9 deals with _____.
- A. Direct Material Cost
 - B. Indirect Material Cost
 - C. Packing Material Cost
 - D. Imported Material Cost
- (viii) Which of the following statements is not true about a continuous audit?
- A. It is conducted at regular intervals.
 - B. It may be carried out on daily basis.
 - C. It is needed when the organisation has a good internal control system.
 - D. It is expensive.
- (ix) The company's auditor is expected to give _____.
- A. His expert opinion about the accounts.
 - B. A factual position about the accounts.
 - C. A critical review of the accounts.
 - D. Financial assistance.
- (x) The principle of 3D vision includes _____.
- A. Time dimension analysis.
 - B. Space dimension analysis.
 - C. Both (a) & (b).
 - D. None of the above.

Answer:

i	ii	iii	iv	v	vi	vii	viii	ix	x
C	D	D	A	A	A	C	C	A	C



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(b) Following data are made available by Company X for its Product A

Particulars	₹ Lacs
Sales	24,475
Less: Variable Cost	13,429
Contribution	11,046
Less Fixed Cost	4,557
Profit	6,489

From the Above Data, Cost Auditor is asked to advise for the following:

- (i) Sales at BEP of company X:
- A. ₹10,097.10
 - B. ₹11,000.20
 - C. ₹11,078.35
 - D. ₹12,035.52
- (ii) P/V Ratio(%) of company X:
- A. 45.21
 - B. 44.26
 - C. 48.25
 - D. 45.13
- (iii) Contribution at Break Even point of Sales:
- A. 4589
 - B. 4557
 - C. 4253
 - D. 4569
- (iv) Sales above BEP of company X:
- A. ₹14,897
 - B. ₹14,565
 - C. ₹14,378
 - D. ₹14,225
- (v) Variable cost ratio(%) of company X:
- A. 54.87
 - B. 54.79
 - C. 51.75
 - D. 55.74

Answer:

i	ii	iii	iv	v
A	D	B	C	A



SECTION – B

(Answer any five questions out of seven questions given. Each question carries 14 Marks)

[5x14=70]

2. (a) Describe the Advantages of Cost Audit.

[7]

Answer:

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.”

The liberalization of the economy and consequential globalization has further enhanced the need for authentic data. The Expert committee formed by the Government of India to study the Cost Audit scenario in the country, highlighted the following benefits of cost information:

(a) Cost information enables the organisation to structure the cost, understand it and use it for communicating with the stakeholders.

(b) Costing is an important tool in assessing organisational performance in terms of shareholder and stakeholder value. It informs how profits and value are created, and how efficiently and effectively operational processes transform input into output. It contributes to the data input on economy level parameters like resources efficiency, waste management, resources allocation policies etc.

(c) Costing includes product, process, and resource-related information covering the functions of the organisation and its value chain. Costing information can be used to appraise actual performance in the context of implemented strategies.

(d) Good practice in costing should support a range of both regular and non-routine decisions when designing products and services to:

- meet customer expectations and profitability targets;
- assist in continuous improvements in resources utilisation; and
- guide product mix and investment decisions.

(e) Working from a common data source (or a single set of sources) also helps to ensure that output reports for different audiences are reconcilable with each other.

(f) Integrating databases and information systems can help to provide useful costing information more efficiently as well as reducing source data manipulation.

(b) Explain the key requirements for preparing cost statements under Clause 28, including production data, cost elements, tax reconciliation, and reporting for multiple locations. [7]

Answer:

(a) Cost statements (monthly, quarterly and annually) showing quantitative information in respect of each goods or service under reference shall be prepared showing details of available capacity, actual production, production as per excise records, production as per GST records, capacity utilisation (in-house), stock purchased for trading, stock and other adjustments, quantity available for sale, wastage



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and actual sale, total quantity of outward supplies as per cost records and total outward supplies as per GST records during current financial year and previous year.

- (b) Such statements shall also include details in respect of all major items of costs constituting cost of production of goods or services, cost of sales of goods or services and margin in total as well as per unit of the goods or services. The goods or services emerging from a process, which forms raw material or an input material or service for a subsequent process, shall be valued at the cost of production or cost of service up to the previous stage.
- (c) Cost statements (monthly, quarterly and annually) in respect of reconciliation of indirect taxes showing details of total clearances of goods or services, assessable value, duties or taxes paid, Tax Credit utilised, duties or taxes recovered and interest or penalty paid.
- (d) If the company is operating more than one plant, factory or service centre, separate cost statements as specified above shall be prepared in respect of each plant, factory or service centre.
- (e) Any other statement or information considered necessary for suitable presentation of costs and profitability of goods or services produced by the company shall also be prepared

3. (a) **Discuss the disqualifications of a cost auditor under section 141 of the companies Act, 2013.** [7]

Answer:

As per Section 141(3), read with Rule 10 of Company (Audit and Auditor) Rule 2014 and Section 148, the following persons shall not be eligible for appointment as Cost auditor of a company:

- (a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
- (b) an officer or employee of the company;
- (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
- (d) a person who, or his relative or partner:
 - (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company, of face value not exceeding rupees one lakh;
 - (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh;
 - (iii) has given a 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, in excess of rupees one lakh;
- (e) 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 of such nature as may be prescribed
- (f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
- (g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;



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- (h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- (i) a person who, directly or indirectly, renders any service referred to in Section 144 to the company or its holding company or its subsidiary company.

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section(3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor [Section 141(4)] read with Sub Rule 3A of Rule 6 of Companies (Cost Records and Audit) Rules, 2014.

- (b) Describe the stages of an Audit of cost statements.

[7]

Answer:

The stages of an audit of cost statements are:

1. Planning
2. Performing
3. Reporting

Once the entity's acceptance or continuation decision has been made, the first stage is planning the audit. Broadly, the planning stage involves: (i) gaining an understanding of the client, (ii) identifying factors that may impact the risk of a material misstatement in the cost statements, (iii) performing a risk and materiality assessment, and (iv) developing an audit strategy. The risk of a material misstatement is the risk that the cost statements include a significant error or fraud. The execution stage (or performing stage) of the audit involves the performance of detailed testing of internal controls and substantive testing of cost accounting policies & procedures. The reporting stage involves evaluating the results of detailed testing in light of the cost auditor's understanding of the entity and forming an opinion on the fair presentation of the entity's cost statements as a whole.

• **Planning an Audit - First Stage**

"It is well said that a well planned audit is almost half way done"

The planning stage involves determining the audit strategy as well as identifying the nature and the timing of the procedures to be performed. This is done to optimize efficiency and effectiveness when conducting an audit. Efficiency refers to the amount of time spent gathering audit evidence. Effectiveness refers to the minimization of audit risk. A well-planned audit will ensure that sufficient appropriate evidence is gathered to minimize risk of material misstatement at the cost statement level.

• **Performing an Audit – Second Stage**

The performance, or execution, stage of the audit involves detailed testing of internal controls, material consumptions, cost accumulation, allocation, apportionment, and absorption. If an auditor plans to rely on their client's system of internal controls, they will conduct tests of controls. Cost auditor will conduct detailed substantive tests of audit procedures for the period and detailed substantive tests of consumptions and balances recorded at the period end. This detailed testing provides the evidence that the cost auditor requires to determine whether the cost statements have been fairly presented.



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• Concluding and Reporting on an Audit – Final Stage

The final stage of the audit involves drawing conclusions based on the evidence gathered and arriving at an opinion regarding the fair presentation of cost statements. The cost auditor's opinion is expressed in the cost audit report. At this stage of the audit, a cost auditor will draw on their understanding of the client, their detailed knowledge of the risks faced by the client, and the conclusions drawn when testing the entity's controls, transactions, cost heads, item of cost and related disclosures.

4. (a) Following data are given with respect to Electricity Units and Value.

As a Cost Auditor please advise the management how Electricity Cost shall be worked out in accordance with CAS 8:

Sources of Electricity	Units	Rate ₹
Electricity Purchased from State Board	10000000	7
Electricity Purchased from Private Sector	10000000	6
Electricity from Own Power Plant	70000000	4.5
Electricity from Wind Mills		
Cost of Electricity	10000000	3
Credit for Electricity	10000000	5.5

Calculate the following

- Total Electricity Cost
- Average Rate of Electricity

[7]

Answer:

- Total Electricity Cost

	Units	Rate ₹	₹ in Lacs
Electricity Purchased from State Board	10000000	7	700
Electricity Purchased from Private Sector	10000000	6	600
Electricity from Own Power Plant	70000000	4.5	3150
Electricity from Wind Mills			
Cost of Electricity	10000000	3	300
Gross Electricity Cost	100000000		4750
Credit for Electricity from Wind mills	10000000	5.5	550
Net Electricity Cost	100000000	4.2	4200

So, total electricity units which have gone to process is 10 crore kwh. Total Cost of Electricity for Cost Records shall be ₹4,200 Lacs net of Wind Mill Credit.

- Average Rate of Electricity Net of Wind Mill Credit shall be ₹4.2 per kwh.



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(b) Following data are available with respect to cost elements:

Particulars	₹ in Lacs
Raw Material	70
Variable Cost	10
Fixed Cost	30
	110

Actual Capacity Utilisation = 50% = 50000 units

Normal Capacity Utilisation of last 3 years = 80% = 80000 units, Calculate the fixed cost for cost records as per CAS 2. [7]

Answer:

As per CAS 2, capacity utilisation shall be considered as per actual capacity utilisation as the same is significantly less than the normal capacity utilisation.

Here normal capacity utilisation achieved in last 3 years is 80%. However, actual capacity utilisation achieved is 50%.

So, fixed cost equivalent to 50% shall be considered for cost records and for pricing decision = $30 \div 80000 \times 50000 = 18.75$.

So, cost that shall be considered for cost records & for pricing shall be

Particulars	₹ in Lacs
Raw Material	70
Variable Cost	10
Fixed Cost	18.75
	98.75

Fixed Cost relating to significant under utilised capacity which is in this case is $(30 - 18.75) = 11.25$ lacs shall be reported as non cost item to be part of reconciliation statement. Control = $110 - 98.75 = 11.25$.

5. (a) Following data are available for company A:

Sr. No.	Particulars	Value ₹ in Cr.
1	Profit as per Cost Records	100
2	Demurrage for Raw Material	2
3	Previous Year Debit Note included in Raw Material Cost	3
4	Previous Year Settlement paid during the year and booked in Employee Cost	5
5	Interest for Delayed Payment of PF booked in Current Year as Employee Cost	2
6	Insurance Claim Received of Previous Year	2

Prepare Reconciliation Statement showing Profit as per Financial Accounts. [7]



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Answer:

Sr. No.	Particulars	Value ₹ in Cr.
1	Profit as per Cost Records	100
2	Less: Expenses not considered in Cost Accounts but considered in Financial Accounts	
	Demurrage	(2)
	Debit Note of Previous Year	(3)
	Previous Year Settlement	(5)
	Interest on delayed deposits of PF	(2)
	Total	88
3	Add : Insurance Claim not considered in cost accounts	2
	Profit as per Financial Accounts	90

(b) Explain the Code of Ethics for Certified Fraud Examiners.

[7]

Answer:

The Association of Certified Fraud Examiners is an association of professionals committed to performing at the highest level of ethical conduct. Auditors of the Association pledge themselves to act with integrity and to perform their work professionally.

Auditors have a professional responsibility to their clients, to the public interest, and each other; a responsibility that requires subordinating self-interest to the interests of those served.

These standards express basic principles of ethical behaviour to guide Auditors in fulfilling of their duties and obligations. By following these standards, all Certified Fraud Examiners shall be expected, and all Associate Auditors shall strive to demonstrate their commitment to excellence in service and professional conduct.

Code of Ethics for Certified Fraud Examiners:

1. A Certified Fraud Examiner shall, at all times, demonstrate a commitment to professionalism and diligence in the performance of his or her duties.
2. A Certified Fraud Examiner shall not engage in any illegal or unethical conduct or any activity which would constitute a conflict of interest.
3. A Certified Fraud Examiner shall, at all times, exhibit the highest level of integrity in the performance of all professional assignments, and will accept only assignments for which there is a reasonable expectation that the assignment will be completed with professional competence.
4. A Certified Fraud Examiner will comply with lawful orders of the courts and will testify to matters truthfully and without bias or prejudice.
5. A Certified Fraud Examiner, in conducting examinations, will obtain evidence or other documentation to establish a reasonable basis for any opinion rendered. No opinion shall be expressed regarding the guilt or innocence of any person or party.
6. A Certified Fraud Examiner shall not reveal any confidential information obtained during a professional engagement without proper authorization.



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7. A Certified Fraud Examiner shall reveal all material matters discovered during an examination, which, if omitted, could cause a disorder.
8. A Certified Fraud Examiner shall continually strive to increase the competence and effectiveness of professional services performed under his or her direction.

6. (a) **Discuss the responsibility and powers of Enforcement Directorate**

[7]

Answer:

Responsibility

ED 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

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 records

3. Reserve Bank Of India (RBI)

RBI, as India's central banking institution, plays a key role in shaping and enforcing guidelines related to financial transactions, including those under the PMLA.

RBI's guidelines cover aspects such as customer due diligence (CDD), Enhance Due Diligence (EDD), Transaction monitoring and reporting requirements.

4. Securities and Exchange Board of India (SEBI)

SEBI regulates the securities market in India, and is involved in implementing PMLA guidelines related to securities transactions.

5. Other Regulatory Authorities

Various other regulatory bodies, including insurance regulators, pension regulators, and sector – specific regulators, contribute to the implementation of PMLA guidelines in their respective domains.

(b) **Illustrate the qualities of Management Auditor.**

[7]

Answer:

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.



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- 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) Explain the steps involved in an IT Security Audit

[7]

Answer:

A cyber security audit consists of five steps:

- Define the objectives.
- Plan the audit.
- Perform the auditing work.
- Report the results.
- Take necessary action for the deficiencies.

Define the Objectives:

Layout the goals that the auditing team aims to achieve by conducting the IT security audit. Make sure to clarify

the business value of each objective so that specific goals of the audit align with the larger goals of the company. List of questions as a starting point for brainstorming and refining of objectives for the audit.

- Which systems and services do want to test and evaluate?
- Do audit digital IT infrastructure, physical equipment, and facilities, or both?
- Is disaster recovery on the list of concerns? What specific risks are involved?
- Does the audit need to be geared towards proving compliance with a particular regulation?

Plan the Audit:

A thoughtful and well-organized plan is crucial to success in an IT security audit.

Define the roles and responsibilities of the management team and the IT system administrators assigned to perform the auditing tasks, as well as the schedule and methodology for the process. Identify, monitor, report, and data classification tools that the team will use and any logistical issues they may face, like taking equipment offline for evaluation.

Once decided on all the details, document and circulate the plan to ensure that all staff members have a common understanding of the process before the audit begins.



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Perform the Auditing Work:

The auditing team should conduct the audit according to the plan and methodologies agreed upon during the planning phase. This will typically include running scans on IT resources like file-sharing services, database servers, and SaaS applications like Office 365 to assess network security, data access levels, user access rights, and other system configurations. Also physically inspect the data center for resilience to fires, floods, and power surges as part of a disaster recovery evaluation.

During this process, interview employees outside the IT team to assess their knowledge of security concerns and adherence to company security policy, so any holes in the company's security procedures can be addressed moving forward.

Report the Results:

Compile audit-related documentation into a formal report that can be given to management stakeholders or the regulatory agency. The report should include a list of any security risks and vulnerabilities detected in IT systems, as well as actions that IT staff recommend to mitigate them.

Take Necessary Action:

Follow through with the recommendations outlined in the audit report. Examples of security-enhancement actions can include:

- Performing remediation procedures to fix a specific security flaw or weak spot/s.
- Training employees in data security compliance and security awareness.
- Adopting additional best practices for handling sensitive data and recognizing signs of malware and phishing attacks.
- Acquiring new technologies to strengthen existing systems and regularly monitor infrastructure for security risk.

(b) Discuss the various tools & techniques which are used in Environmental Auditing. [7]

Answer:

Environmental audit is an independent evaluation of policy and principles, systems, procedures, practices in place and performance, and other elements of a business relating to the environment.

Some of the tools which can be used in environmental audits are:

- **Checklists:** Checklists are very useful tools used to ensure that different tasks or topics are included in the assignment w.r.t scope. during the audit. They are very useful in specialized cases where a complex range of issues and questions need to be asked to ensure that nothing is missed.
- **Questionnaires:** Audit protocols or audit questionnaires provide the basis and structuring for most audits. They are based upon checklist questionnaires but are more complex and include more detail and sometimes logistical information and data relating to the audit and the site being audited.
- **Questioning:** Questioning is one of the most crucial aspects of auditing yet from a training and awareness point of view, it is often given the least attention. The purpose is information gathering in nature and not an interrogation. The questioner must, therefore, be sensitive to the perspective of the auditee and avoid making the questions accusatory, judgmental or aggressive.



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- **Observation:** Observation is a vital component of an auditing exercise. Observation is a disciplined activity that must be carried out in a very deliberate and controlled manner. The idea of looking at something twice is important because it is part of the process that checks that the observation is accurately noted, analysed, and recorded.
- **Photographs:** These are a very valuable aid in the audit process. However, to use them, several important practical points must be borne in mind, the most important one is formal approval before using this technique.
- **Research:** It is useful to try and undertake some background research and investigation into the site or company to be audited. Familiarization with the operations, products, raw materials reports, press material, newspaper articles, etc. all provides useful background information to supplement questioning sessions and help understand the operational processes.

8. (a) Explain the objectives of Internal Audit

[7]

Answer:

It is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control and governance process.

Objectives of Internal Audit

- To check the accuracy and authenticity of the accounting records, which are reported to those charged with governance.
- To identify whether the standard accounting practices, which are deemed to be pursued by the entity, are complied with or not.
- To ensure early detection of fraud, errors and prevention of fraud.
- To examine that transactions are recorded after due approval by appropriate authority.
- To verify that the liabilities are incurred only for business causes and not for any other purpose.
- To review the activities of the internal control system, so as to report management regarding deviations and non-compliances.

(b) Discuss the steps involved in the Audit of Hospitals.

[7]

Answer:

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

- Check the letter of appointment to ascertain the scope of responsibilities.
- Ownership and control of the institution.
- 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.
- Donation, Special Grant, Interest and/ or dividend income etc. to be validated through necessary supporting documents, should be vouched with reference to the Investment Register and Interest and Dividend warrants.



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- Ensure purposive donations, grants etc. spent for the particular purpose only.
- Clear distinction should be made between the items of capital and revenue nature.
- Adherence to Standard Operating procedure w.r.t Expenses (Capex and Op.ex)
- Verify the system of internal check as regards purchases and issue of stores, medicines, medical equipment etc.
- Examine that the appointment of the staff, visiting specialist doctors, payment of salaries etc. for expenditure booking validation.
- Physically verify the investments, fixed assets and inventories.
- Check appropriateness of capitalization and depreciation rates charged and value in Books.