Module 1 · Basics of Cost Audit P17 · topics 1.1–1.5

SM pp. 3–12, only seven pages of text — and **56 marks in 7 papers**: **Q2(a), 7 marks, in every paper** (objectives three times, scope twice, benefits, advantages of CAS) plus an MCQ (year 1965, cement, objectives). These pages are worth learning word for word.

Paper	Q2(a) · MCQ	Paper	Q2(a) · MCQ
Jun'23	**social objectives** · MCQ primary objective = accuracy of cost data	Jun'25	**general objectives** (= PTP Q2(a))
Dec'23	**benefits of cost audit** · MCQ first industry: cement	Dec'25	**main purposes** · MCQ year: 1965
Jun'24	**scope of cost audit**	Jun'26	**define cost audit, scope, social objectives**
Dec'24	**advantages of CAS** · MCQ objectives	Dec'26?	**benefits of cost information (Expert Committee)** — ICMAI MQP Q2(a), never asked

1.1 Nature and scope of cost audit · Jun'24, Jun'26 Q2(a)

THREE DEFINITIONS (SM WORDS)

- **CIMA, London**: "the **verification of the correctness of cost accounts** and of the **adherence to the cost accounting plan**" — i.e. verification of the cost of production of any product, service or activity on the accounts kept per accepted cost accounting principles. [SM 3]
- **ICMAI**: "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." [SM 3]
- Cost audit is an **independent examination** of cost statements, cost records and related information, **with a view to express an opinion** thereon. [SM 3]
- ICWAI: "An audit of **efficiency of minute details of expenditure** ... mainly a **preventive measure**, a guide for management policy and decision ... and a **barometer of performance**." [SM 3]

CAS vs cost auditing standards: cost accounting practices and principles are in the **Cost Accounting Standards**; cost auditing procedures in the **Standards on Cost Auditing**, the best guide for the auditor (better planning, documentation, implementation; may rely on another auditor's or expert's work). Preparing cost records and statements is **management's responsibility**. [SM 3]

SCOPE (THE JUN'24 / JUN'26 ANSWER)

The **primary objective** is the **accuracy of cost data**, accumulation and exact computation of the cost of a product (Jun'23 MCQ), but its vast scope works as a **mirror of the entity's performance**. Beyond propriety it covers overall **efficiency** and its improvement. It can help: [SM 3–4]

a. **control over element-wise cost**;
b. determining **sales price and margin**;
c. management in **decision-making**;
d. necessity and results of each **activity**;
e. setting **standards and budgetary controls**;
f. **minimizing wastages**;
g. accuracy of **inventory valuation**;
h. **overall efficiency improvement**.

[SM 4]

SM WORDS Cost Audit is not only a **compliance tool** (where mandatory); its outcome goes **"beyond compliance"**. [SM 4]

1.2 Genesis of cost audit · Dec'23 + Dec'25 MCQs, PTP and postal MCQs

- Pre-independence **cost-plus** Government contracts → cost investigation; World War II made cost a distinct concept; the Institute was set up in **1944** to promote, regulate and develop the profession. [SM 5]
- Mid-fifties **Dalmia-Jain** frauds → **Vivian Bose Commission**, then the Dutta Commission and the Daphtary-Sastri Committee: they recommended effective cost accounting and cost audit to supplement financial audit (SM fill-in: **Vivian Bose**). Scarcity led to price controls based on cost. [SM 5]

Year	The Institute
1944	ICWAI set up under the Companies Act 1913, as a limited company
1959	statutory body under the Cost and Works Accountants Act, 1959
2012	renamed **The Institute of Cost Accountants of India**

[SM 5]

Year	Cost audit
1965	cost audit **first introduced**: **s.233B** (audit) and **s.209(1)(d)** (records) of the Companies Act 1956; first industry: **cement** (SM MCQ 1–2)
1965–2008	**44** industries covered, company by company
2008 / 2009	**Expert Group** set up / reports to the CG
2011	**mandatory** cost audit for manufacturing, mining, processing by turnover and net worth limits; compliance certificate
2014	Companies (Cost Records and Audit) Rules, 2014 under the 2013 Act

[SM 5–6, SM 12]

s.148 in one line each: (1) CG may order cost particulars in the books (consult the regulator of a special-Act company); (2) CG may order **cost audit** by net worth or turnover; (3) by a **cost accountant in practice** appointed by the **Board**, remuneration fixed by the **members**; not the s.139 auditor; must follow **cost auditing standards** (ICMAI, with CG approval); (4) in addition to the s.143 audit; (5) auditor rules apply; the company gives all assistance; report to the **Board**; (6) company sends it to the CG within **thirty days** of receipt with explanations; (7) CG may call for more; (8) default: company and officers → **s.147(1)**; cost auditor → **s.147(2)–(5)** (SM MCQ 5). [SM 6]

1.3 Objectives of cost audit · Jun'23, Jun'25, Dec'25 Q2(a), PTP Q2(a), Dec'24 MCQ

GENERAL OBJECTIVES (12, SM ORDER)

1. verify that cost accounts are **properly maintained and compiled** under the system followed;
2. ensure the **prescribed procedures** of the cost records rules are followed;
3. **detection of errors and fraud**;
4. verify the cost of each **cost unit and cost centre**;
5. determination of **inventory valuation**;
6. help **fix prices** of goods and services;
7. **periodical reconciliation** of cost and financial accounts;
8. **optimum utilization** of human, physical and financial resources;
9. detect and correct **abnormal loss** of material and time;
10. advise management from **inter-unit / inter-firm comparison**;
11. promote **corporate governance** through operational disclosures to directors;
12. help in **anti-dumping**, cost of production valuation, **anti-profiteering** (GST), price controls (pharma).

[SM 7]

SOCIAL OBJECTIVES (5) · JUN'23, JUN'26

1. verify that **pricing** is justified for the product and quality;
2. **remove disparities** in pricing of products or services;
3. see that no **cost-based economic imbalance** occurs;
4. help **global cost competitiveness**;
5. ensure **efficient utilization of resources**.

[SM 7]

MEMORY HOOK · "MAIN PURPOSES" (DEC'25)

Write the general objectives under three heads: **Verify** (accounts, procedures, unit costs, inventory, reconciliation) · **Protect** (errors and fraud, abnormal losses, resources) · **Advise** (prices, comparisons, governance, anti-dumping). Add the social objectives as a closing paragraph.

1.4 Utility and advantages · Dec'23 Q2(a); Expert Committee = MQP Q2(a)

- Early years: a tool of **price control** for consumer and infrastructure industries — authentic data for the

BENEFITS OF COST INFORMATION · THE EXPERT COMMITTEE (MQP Q2(a))

Government's **administered price mechanism**. Liberalisation and globalisation raised the need for authentic data. [SM 8]

- **IFAC**: cost audits check that cost records give a **true and fair view** of the cost of production, processing, manufacturing and mining; they benefit **management, consumers and shareholders** by (a) finding **weaknesses** in cost systems and (b) driving down costs by detecting **wastage and inefficiencies**; they help governments frame **tariff and taxation** policies. [SM 8]

a. lets the organisation **structure the cost, understand it** and communicate with stakeholders;
b. assesses **performance** in shareholder and stakeholder value; shows how profit and value are created and how efficiently inputs become outputs; feeds economy-level data (resource efficiency, waste, allocation);
c. product, process and resource information across the **value chain**; appraises performance against **strategy**;
d. supports regular and non-routine **decisions**: meet customer expectations and profit targets; continuous improvement; **product mix and investment**;
e. a **common data source** keeps reports for different audiences reconcilable;
f. **integrated databases** give costing information efficiently and cut data manipulation.

[SM 8]

1.5 Cost Accounting Standards · Dec'24 Q2(a)

SM WORDS Cost Accounting Standards are a set of standards designed to achieve **uniformity and consistency** in cost accounting principles and practices; ICMAI constituted the **Cost Accounting Standards Board (CASB)** to formulate them (SM T/F 4: not the auditing standards board). They: (1) give a **structured approach** to measuring costs; (2) **integrate, harmonize and standardize** principles and practices; (3) guide users to **uniformity and consistency** in classification, measurement, assignment and allocation; (4) give the **basis of cost** where required by **legal or regulatory bodies**; (5) let practising members use CAS in **attesting General Purpose Cost Statements**; (6) give a **clear and uniform understanding** to users, Government bodies, regulators, researchers and academics. *For Dec'24's "advantages to industry, users and Government", sort these six under those three heads.* [SM 9]

EX The SM's own exercise (SM 10–12)

1 cost audit first introduced ★	**1965** (= Dec'25 MCQ)	T/F 3 report to the CG within 30 days of	**receipt**, not signing — F
2 first industry ★	**cement** (= Dec'23 MCQ)	T/F 4 CAS formulated by	**CASB**, not CAASB — F
3 mandatory cost audit ordered	**2011** (postal MCQ)	T/F 5 the cost auditor complies with	cost **auditing** standards — F
4 report submitted to	**Board of Directors**	fill-ins	Institute set up **1944** · **Vivian Bose** · company default s.**147(1)** · renamed **2012**
5 cost auditor in default punished under	**s.147(2)–(5)**	T/F 1–2	WWII contracts on cost-plus (F as worded); 1944 objective = promote, regulate, develop (F)

[SM 10–12]

Module 2 · Companies (Cost Records and Audit) Rules, 2014 P17 · topic 2.1

SM pp. 15–92. **110 marks in 7 papers — second only to the CAS.** Two slots every paper: **Q2(b) theory** (applicability, forms, items in Form CRA-1) and **Q5(a) a sum** (profit reconciliation or value addition, Part D of the Annexure to CRA-3), plus 1–3 MCQs. The SM's own Illustrations 1–9 and Cases 1–5 (SM 73–88) are where the Q5(a) sums come from: Jun'26 Q5(a) is Illustration 2 with the **same figures**.

Paper	What was asked from the CRA Rules	Marks
Jun'23	Q2(b) **value addition and earnings for distribution** (Part D para 3)	10
Dec'23	MCQ: electricity companies regulated (= SM MCQ 4) · Q2(b) **normal capacity vis-a-vis installed capacity in CRA-1** · Q5(a) **reconciliation** (Illustration 5 items)	2 + 7 + 7
Jun'24	MCQ: exports above 75% (Rule 4(3)) · Q2(b) **"normal price" for related party transactions** · Q5(a) **reconciliation** (Illustration 7 items)	2 + 7 + 7
Dec'24	MCQ: defence machinery → non-regulated · Q2(b) **applicability of cost audit** · Q5(a) **value addition**	2 + 7 + 7
Jun'25	MCQs: secondary packing · sugar regulated · wages particulars in the report · Q2(b) **CRA forms** · Q5(a) **reconciliation** (Illustration 4 items)	6 + 7 + 7
Dec'25	MCQ: CRA-2 signed by persons authorised by the Board · Q2(b) **particulars of repairs and maintenance** in cost records · Q5(a) **reconciliation** (Illustration 5 items again)	2 + 7 + 7
Jun'26	MCQ: regulated threshold ₹50 crore (= SM MCQ 1) · Q2(b) **finance costs** in cost records + assignment · Q5(a) **value addition** (= Illustration 2, same data; postal Q2(a))	2 + 7 + 7

HOW IT IS EXAMINED · DEC'26 PREDICTION

- **Q5(a), 7 marks, about 97% likely**: **reconciliation** is the better bet (all three Jun'26 practice papers have one; Jun'26 was value addition). Practise SM Illustrations 4–9 and 1–3.
- **Q2(b), 7 marks, about 97% likely**: (1) **areas of the cost accounting policy** (MQP; not yet asked); (2) an **applicability case** from product turnovers (PTP, postal; SM Cases 1–5); (3) particulars of **another CRA-1 item** (R&M and finance costs done; utilities, employee cost, packing, capacity next); (4) the **forms** and their time limits.
- MCQs: thresholds 35 / 50 + 25 / 100 + 35; exports 75%; regulated or not; which form; 30 / 180 days.

MAP OF THIS PACK

1. Rules 1–4: application, sectors, thresholds, exemptions ★★★
2. Applicability cases (SM Cases 1–5) ★★
3. Rules 5–6: records, appointment, timelines ★★★
4. Forms CRA-1 to CRA-4; the Annexure (Parts A–D) ★★
5. CRA-1: the 31 heads and the asked ones ★★★
6. Part D: reconciliation (3 sums) ★★★
7. Part D: value addition (2 sums) ★★★
8. SM exercise · numbers

R.1–4 Who must keep cost records, who needs cost audit

RULE 3
Domestic or **foreign** company
→
product or service **listed in Table A or B**
→
overall turnover ≥ ₹35 crore (preceding FY) → **cost records** (CRA-1)
→
RULE 4
A: overall ≥ **₹50 cr** and Rule 3 products ≥ **₹25 cr**
B: overall ≥ **₹100 cr** and ≥ **₹35 cr**
→
cost audit unless an exemption applies

[SM 16–17, SM 22, SM 25]

RULE 3 · APPLICATION OF COST RECORDS

- SM WORDS The class of companies, including **foreign companies** (s.2(42)), engaged in the production of the goods or providing services specified in the Table, having an **overall turnover from all its products and services of rupees thirty five crore or more during the immediately preceding financial year**, shall include cost records for such products or services in their books of account. [SM 22]

RULE 4 · APPLICABILITY FOR COST AUDIT

- SM WORDS **4(1)** Table A companies: overall annual turnover from all products and services in the immediately preceding FY is **rupees fifty crore or more** and the aggregate turnover of the individual product(s) or service(s) for which cost records are required is **rupees twenty five crore or more**. [SM 25]
- **4(2)** Table B companies: overall **rupees one hundred crore or more** and aggregate of Rule 3 products **rupees thirty five crore or more**. [SM 25]

- **(A) Regulated sectors (6):** telecommunication (TRAI); electricity — **generation, transmission, distribution and supply** (Dec'23 MCQ: all of these); petroleum products (PNGRB); **drugs and pharmaceuticals**; **fertilisers**; **sugar and industrial alcohol** (Jun'25 MCQ: regulated). [SM 22]
- **(B) Non-regulated sectors (33)**, e.g. machinery for **defence, space and atomic energy** (Dec'24 MCQ: non-regulated); turbo jets; arms; radar; tanks funded 90% or more by Government; **port services**; **aeronautical services**; iron and steel; roads; rubber; coffee and tea; railways; cement; ores; mineral fuels; base metals; chemicals; jute; edible oil; **construction**; **health services** (No. 22: hospitals, diagnostic centres); **education services** (No. 23, not philanthropy); milk powder; insecticides; plastics; tyres; paper; textiles; glass; other machinery; electricals; **medical devices** (No. 33: stents, catheters, implants, pacemakers…). [SM 22–24]
- **Out of the rules:** a **micro or small enterprise** under the MSMED Act 2006 (incl. by turnover); No. 33 does not apply to foreign companies with only **liaison offices**. [SM 25]

- SM WORDS **4(3) Cost audit does not apply** to a company covered in Rule 3: (i) whose revenue from **exports, in foreign exchange, exceeds seventy five per cent** of its total revenue (Jun'24 MCQ); (ii) operating from a **special economic zone**; (iii) generating electricity for captive consumption through a **Captive Generating Plant** (Electricity Rules 2005). Rule 3 (records) still applies. [SM 17, SM 25]
- **Turnover** = gross turnover from sale or supply of all products and services, **excluding duties and taxes**: SM Illustration 9(a) counts sales, depot trading sales, export income, job processing, scrap sale and loan-licence income, and leaves out export duty. [SM 84–85]
- Rule 1: in force from publication, **30.06.2014**; amended 31 Dec 2014, 12 June 2015, 14 July 2016; latest **15th October, 2019**. [SM 15, SM 21]

MODEL ANSWER 1 · APPLICABILITY FROM PRODUCT TURNOVERS (DEC'24 Q2(b), PTP Q2(b), POSTAL Q2(b)/Q4/Q5) · THE SM'S FIVE CASES

Case (₹ crore)	Table A	Table B	Others	Overall	Cost records (Rule 3)	Cost audit (Rule 4)
1 XYZ & Co.	6	9	18	33	No (below 35)	does not arise
2 ABC Ltd	7	8	24	39	Yes, A and B	No: overall below 50; Rule 3 products 15 < 25
3 B. K. Pvt	11	14	28	53	Yes	**Table A only**: overall ≥ 50 and Rule 3 products 25
4 Sun Enterprise	19	15	76	110	Yes	**Table A only**: Rule 3 products 34 ≥ 25 but < 35
5 Alpha Pvt	20	22	63	105	Yes	**A and B**: overall ≥ 100 and Rule 3 products 42 ≥ 35

[SM 25, SM 86–88]

How to write it: (1) Rule 3 test on **overall** turnover; (2) Rule 4(1) for Table A and 4(2) for Table B, each on overall + aggregate of Rule 3 products; (3) check the exemptions (exports above 75%, SEZ, captive power); (4) conclude product-wise. SEZ and non-SEZ units together (SM short essay 1, no SM answer): **records** for all units; ⚠ our reading is that the SEZ exemption removes **audit** only for the unit operating from the SEZ, while the non-SEZ unit stays under Rule 4 if the thresholds are met.

R.5–6 Maintenance of records · appointment and the cost audit timeline

RULE 5 · MAINTENANCE

- Every company under the rules, incl. **all units and branches**, for each FY from **1st April, 2014**, maintains cost records in **Form CRA-1**; for coffee and tea (No. 12) and Nos. 24–32 of Table B, from **1st April, 2015**. [SM 25]
- On a **regular basis**, so as to calculate per unit cost of production or operations, cost of sales and margin for each product and activity, **monthly, quarterly, half-yearly or annually**; to exercise control over operations and costs and achieve optimum economies. [SM 25]
- **Records (not exhaustive):** production (consumption, rejection, machine running hours, idle time); WIP and finished goods; repairs (job cards); utilities (input-output, source-wise own vs purchased power); service centres (QC, R&D, pollution: basis of apportionment); materials (GRN, bin cards, ledgers, physical verification); wages (attendance, overtime, **VRS, retrenchment, lay-off**);

RULE 6 · COST AUDIT

1. Appoint a cost auditor **within one hundred and eighty days of the commencement** of every FY, after obtaining his **written consent** and a **certificate** (eligible, not disqualified; satisfies s.141; within limits; list of pending proceedings true). [SM 27]
2. Inform the auditor and file **CRA-2** with the CG within **30 days of the Board meeting** or **180 days of the FY's commencement, whichever is earlier**. [SM 27–28]
3. Tenure: till **180 days from the closure** of the FY or till he submits the report. Removal before that: **Board resolution**, reasonable opportunity of being heard, reasons recorded; new CRA-2 with the resolution. The auditor may resign. [SM 28]
4. **Casual vacancy** (resignation, death, removal): filled by the **Board within thirty days**; CRA-2 within thirty days of the appointment. [SM 28]

overheads; sales (product-wise, export, related parties); related-party and **normal price** data; cost statements; **reconciliation** of cost and financial profit. [SM 25–27]

5. Cost statements are **approved by the Board** before a director authorised by it signs them for the auditor. [SM 28]
6. Report in **CRA-3**, with reservations or qualifications, to the **Board of Directors** within **180 days from the closure** of the FY (SM T/F 3: not the audit committee). [SM 28]
7. Company files the report with the CG in **CRA-4 (XBRL) within thirty days from receipt**, with explanations on every qualification; an AGM extension under s.96(1) extends it to the s.137 period. [SM 28]
8. **s.143(12)** (fraud reporting) applies *mutatis mutandis* to the cost auditor. [SM 28]

Form	What it is · by whom · when
CRA-1	the form in which **cost records** are maintained (Rule 5(1)): headings for each item of cost (next page) [SM 19]
CRA-2	**intimation of appointment** of the cost auditor to the CG (Rule 6(2), 6(3A)): CIN/FCRN, products covered, auditor details, FY covered, previous auditor not reappointed; attach the **Board resolution**; signed by a person **authorised by the Board** (Dec'25 MCQ) [SM 19, SM 51]
CRA-3	the **cost audit report** (Rule 6(4)) + Annexure in Parts A–D; clause (vii): unit-wise and product-wise cost statements are / are not kept [SM 19–20]
CRA-4	**filing the cost audit report** with the CG (Rule 6(6)) in **XBRL**: products covered and not covered, auditor details, observations; attach the XBRL document and the company's explanation on every qualification [SM 20]

Annexure	Contents (Jun'25 MCQ: wages particulars sit in the report)
Part A	1 general information · 2 details of cost auditors · 3 **cost accounting policy** · 4 product / service details (company as a whole) [SM 20]
Part B / C	manufacturing / service sector: quantitative information · abridged cost statement · materials consumed · utilities consumed · industry-specific operating expenses [SM 20]
Part D	1 product and service profitability · 2 **profit reconciliation** · 3 **value addition and distribution of earnings** · 4 financial position and ratios · 5 related party transactions · 6 reconciliation of indirect taxes [SM 20]

CRA-1 Particulars of the items of cost to be kept in the books · Dec'23, Jun'24, Dec'25, Jun'26 Q2(b)

The SM calls them 30 headings but lists **31**: (1) material · (2) employee · (3) utilities · (4) direct expenses · (5) **repairs and maintenance** · (6) fixed assets and depreciation · (7) overheads · (8) administrative overheads · (9) transportation · (10) royalty and know-how · (11) R&D · (12) quality control · (13) pollution control · (14) service departments · (15) **packing** · (16) **finance costs** · (17) any other item · (18) **capacity determination** · (19) WIP and finished stock · (20) captive consumption · (21) by-products and joint products · (22) adjustment of cost variances · (23) **reconciliation of cost and financial accounts** · (24) **related party transactions** · (25) export expenses or incentives · (26) production records · (27) sales records · (28) cost statements · (29) statistical records · (30) physical verification · (31) unit of measurement. Items 1–16 repeat the CAS of the same name (Module 4). [SM 19]

5 · REPAIRS AND MAINTENANCE (DEC'25 Q2(b))

a. records of expenditure of the **workshop, tool room** and repairs in each cost centre, under different heads;
b. cost = **direct** (materials, stores, spares, manpower, equipment usage, utilities) + **indirect** (common manpower, equipment usage);
c. in-house: materials, stores, spares, manpower, equipment, utilities; contractor inside: his charges + own resources; at his premises: invoice price net of discounts (other than cash discount) and refundable taxes + resources supplied;
d. each type of repairs a **distinct activity**; measured per **major asset category**;
e. **spares replaced** that do not enhance future benefits → R&M cost; **major overhaul** amortised;

18 · CAPACITY DETERMINATION (DEC'23 Q2(b))

- In units of production or services, or equivalent machine or man hours. **Installed**: manufacturer's technical specifications; capacities of interrelated centres; critical machines; number of shifts; experts' estimate if no specifications; **reassessed** on addition, discard or process improvement. [SM 45]
- SM WORDS **Normal capacity shall be determined vis-a-vis installed capacity after** adjusting: (i) holidays, normal shut-down days and normal idle time; (ii) normal time lost in **batch change over**; (iii) **preventive maintenance** and normal breakdowns; (iv) loss of efficiency due to **ageing**; (v) number of shifts. **Capacity utilization** = actual production as a % of **installed** capacity. [SM 45]

24 · RELATED PARTY TRANSACTIONS (JUN'24 Q2(b))

f. no finance or imputed cost; price variances and normal usage variances in;

g. subsidy reduced; **abnormal** (fire, explosion, flood) and **fines** excluded; credits deducted;

h. traced where feasible, else **cause and effect** or **benefits received**; shared cost aggregated and distributed.

[SM 33–35]

16 · FINANCE COSTS (JUN'26 Q2(b))

a. SM WORDS finance costs are costs incurred in connection with the **borrowing of fund** or other costs which in effect represent payment for the use of **non-equity fund**;

b. identified for (i) **qualifying assets** incl. fixed assets and (ii) other finance costs for production or services;

c. those directly attributable to a qualifying asset are **included in the cost of the asset**;

d. no imputed costs; subsidy reduced;

e. **penal interest**, fines, penalties excluded (interest for late statutory dues is not penal interest);

f. interest paid or received on **investment** excluded from production financing;

g. **assignment**: (1) **cause and effect**, (2) **benefits received**.

[SM 44–45]

- Related party as in **s.2(76)** of the Companies Act, 2013. [SM 46]
- SM WORDS **"Normal" price** means price charged for comparable and similar products in the ordinary course of trade and commerce where the price is the **sole consideration** of sale and the sale is **not made to a related party**; the price at which **two unrelated and non-desperate parties** would agree, not clouded by their proximity. [SM 46]
- **Basis of normal price:** (i) comparable uncontrolled price; (ii) resale price; (iii) cost plus; (iv) profit split; (v) transactional net margin; (vi) any other method, specified. [SM 46–47]
- Records of contracts for purchase and sale of materials and goods, use of plant and know-how, utilities, consultancy, capital goods, other payments, with the **basis of rates** to judge reasonableness. [SM 47]

15 · PACKING · 23 · RECONCILIATION · 28 · COST STATEMENTS

- Separate records for **domestic and export** packing; **primary packing → cost of production; secondary → distribution overheads** (Jun'25 MCQ). [SM 43–44]
- Cost statements reconciled with financial statements, showing **expenses or incomes not considered** in cost records; variations explained. [SM 46]
- Cost statements (monthly, quarterly, annually): capacity, production as per excise and **GST** records, utilisation, cost of production, cost of sales and margin, in total and per unit; a separate statement per plant. [SM 48]

OTHER HEADS IN ONE LINE EACH

2 Employee: cost centre-wise; gross pay + benefits incl. retirement benefits (Ind AS re-measurements in OCI excluded); executive directors in, non-executive → admin. **6 Depreciation**: as recognised in the financial statements (Schedule II); temporarily retired asset → abnormal; impairment out. **7 Overheads**: variable on actual capacity, **fixed on normal capacity**; operating-lease rentals → admin. **9 Transport**: outward cost apportioned by weight, volume, tonne-km, unit, value, space. **19 WIP / FG**: all conversion costs to present location and condition, method consistent. **22 Variances**: material, labour, overheads, into quantity, price, efficiency, with reasons. **25 Exports**: cost of export sales; export commitments licence-wise. **29 Statistical**: machine and labour hours, capital employed. **31 UoM**: as in the Customs Tariff Act. [SM 30–31, SM 35–37, SM 45–48]

D-2 Profit reconciliation (Part D para 2) · the Q5(a) sum asked 4 times

THE FORMAT (PART D-2) AND THE RULE

(1) Profit as per **cost** accounts (audited + un-audited products) · (2) **add** incomes not considered in cost accounts · (3) **less** expenses not considered · (4) difference in **stock valuation** · (5) other adjustments · (6) = profit as per **financial** accounts. Show abnormal wastage, strike expenses and abnormal items separately. Questions usually start from the financial profit, so reverse every sign. [SM 64]

STARTING FROM FINANCIAL PROFIT: SIGN RULES

- **Less** incomes only in financial accounts: profit on sale of assets, dividend or interest on outside investments, insurance claim of an earlier year, subsidies, trading profit, exchange gain, refunds.
- **Add** expenses only in financial accounts: CSR, donations, VRS, loss on sale of assets or investments, trading loss, the **unexpired 4/5th** of a renovation or overhaul charged in full.
- **Stock**: overvalued closing stock in financial accounts → **less**; overvalued opening stock → **add**.

[SM 79–85]

MODEL ANSWER 2 · DEC'25 Q5(a) (THE SAME SIX ITEMS AS DEC'23 Q5(a) AND SM ILLUSTRATION 5 = ICMAI PTP Q5(a)) · 7 MARKS

Reconciliation of profit, 2024-25	**₹**	**₹**
Profit as per financial accounts		17,73,350
Add: trading loss (6,75,000 + 20,400 − 6,71,150), not a cost-accounts item	24,250	
Add: 4/5th of renovation 3,87,500 (useful life five years; one year's 77,500 is cost)	3,10,000	
Add: CSR expenditure	29,000	3,63,250
Less: profit on sale of machine (4,65,000 − 3,27,000)	1,38,000	
Less: dividend from investments	42,250	
Less: net overvaluation of closing inventory in financial records (32,700 − 14,800)	17,900	(1,98,150)
Profit as per cost accounts		**19,38,450**

MODEL ANSWER 3 · JUN'25 Q5(a) (= SM ILLUSTRATION 4 WITH NEW FIGURES, ₹ '000) · 7 MARKS

Item	**₹ '000**	**₹ '000**
Profit as per financial accounts		87,806
Less incomes not in cost accounts: profit on sale of fixed assets 160 · urea and transport subsidy 358 · prior-year litigation recovery 135 · favourable exchange variation 304 · purchase tax refund 463 · own-consumption valuation difference (392 − 375) 17	1,437	(1,437)
Add expenses not in cost accounts: CSR 66 · post-retirement medical grant 594	660	660
Stock: increase in financial accounts (1,25,950 − 1,16,920 = 9,030) minus increase in cost accounts (1,21,570 − 1,15,800 = 5,770)	3,260	(3,260)
Profit as per cost accounts		**83,769**

MODEL ANSWER 4 · JUN'24 Q5(a) (= SM ILLUSTRATION 7 WITH NEW FIGURES) · 7 MARKS

Item	**₹**	**₹**
Profit as per financial accounts		33,18,100
Add: loss on sale of investments 45,600 · VRS compensation in F/A 56,25,000 · donation 80,000	57,50,600	90,68,700
Less: profit on sale of fixed assets 3,05,000 · prior-year insurance claim 5,28,700 · retail trading profit 30,00,600 · ICD interest 7,25,000	45,59,300	
Less: decrease in inventory per cost accounts 3,98,15,200 − per financial accounts 3,92,06,480	6,08,720	(51,68,020)
Profit as per cost accounts		**39,00,680**

D-3 Value addition and distribution of earnings (Part D para 3) · Jun'23, Dec'24, Jun'26

THE FORMAT (PART D-3)

Revenue from operations − taxes and duties = **net revenue** · + export incentives · ± adjustment in stocks · − **cost of bought-out inputs** (materials, process materials, stores and spares, utilities, others) = **value added** · + income from other sources · + exceptional income, OCI = **earnings available for distribution**. **Distribution to:** employees · shareholders (dividend) · company (retained funds) · Government (taxes) · exceptional expenses · others. [SM 65]

SM definition used in Illustration 1: value addition is the difference between the net output value (net sales) and the cost of bought-out materials and services. [SM 74]

HOW THE SM SORTS THE ITEMS

- **Bought-out "other overheads"**: other manufacturing OH, audit fees, other admin OH, packing and forwarding, other S&D OH, **interest on working capital loans**.
- **Not bought-out** (they are distributions): wages and salaries (incl. S&D salaries), directors' pay, cess and local taxes, income tax, dividend, interest on **fixed loans and debentures**, depreciation (sits in retained funds).
- Retained funds = earnings − employees − directors − dividend − taxes − interest.

[SM 76, SM 78]

MODEL ANSWER 5 · JUN'26 Q5(a) = SM ILLUSTRATION 2 (SINJINI LTD), SAME FIGURES (₹ LAKH) · 7 MARKS

Value addition	2026	2025	Distribution of earnings	2026	2025
Net sales + increase in FG stock (20 / 10)	4,820	3,850	Employees (440 + 36; 352 + 30)	476	382
Less: raw materials	1,760	1,440	Directors: salaries and commission	48	40
Less: stores and spares · power and fuel	160 + 240	140 + 192	Shareholders: dividend	420	230
Less: other overheads (430+36+260+20+250+60; 370+30+220+16+200+25)	1,056	861	Government: local taxes + income tax (120+316; 100+200)	436	300
Value added (bought-out 3,216 / 2,633)	**1,604**	**1,217**	**Interest: debentures + IDBI (30+90; 30+70)**	**120**	**100**
+ other income 300 / 200 = earnings for distribution	**1,904**	**1,417**	**Company: retained funds (incl. depreciation)**	**404**	**365**

[SM 75–76]

MODEL ANSWER 6 · DEC'24 Q5(a) WXY LTD (₹ LAKH), SAME METHOD · 7 MARKS

Item	2024	2023
Revenue from operations incl. GST 10,324 / 8,773 less GST 510 / 440 = net revenue	9,814	8,333
Add: export incentives 116 / 103 · increase in finished stock 235 / 182	10,165	8,618
Less bought-out inputs: materials 5,278 / 4,473 · stores 348 / 287 · power 522 / 450 · manufacturing OH 203 / 186 · packing 44 / 35	(6,395)	(5,431)
Value added	**3,770**	**3,187**
Add: income from other sources 218 / 178 = **earnings for distribution**	3,988	3,365
Distributed: wages 1,325 / 1,115 · dividend 175 / 160 · income tax 385 / 190 · interest 265 / 201 · retained (balance)	1,838	1,699

Interest is not split here, so all of it is shown as a distribution to providers of capital; if a question splits out working-capital interest, treat that part as a bought-out input (SM Illustration 2).

EX The SM's own exercise for Module 2 (SM 89–92) · numbers

1 regulated: cost audit threshold ★	**₹50 crore or more** (= Jun'26 MCQ)	7 report filed on the MCA portal in	**CRA-4**
2 CRA-4 uploaded under	**Rule 6(6)**	8 CRA-1 pertains to	**cost accounting records**
3 form of cost records	**CRA-1**	9 report prepared in	**CRA-3**
4 electricity regulated ★	**all the above** (= Dec'23 MCQ)	10 general information in	**Part A-1**
5 not regulated	**automobile**	11 Table B item for health services	**22**
6 casual vacancy filled within	**30 days**	12 notice of appointment	**CRA-2**

True/False: (1) only **micro and small** enterprises are out (not medium) — F; (2) exports above 75% removes **audit**, not records — F; (3) report goes to the **Board**, not the audit committee — F; (4) tenure ends 180 days after the FY **or on submitting the report** — F; (5) ss.139, 143, 144, 145 apply to the cost auditor (s.148(5)) — T. **Fill-ins:** report in **CRA-3** · company files within **30 days** · 180 days from closure = **27th September** · maximum fine for a company's default under s.148 = **₹5.00 lacs**. [SM 90–92]

Rule	Number	Rule	Number
cost records (Rule 3): overall turnover	₹35 crore	appoint the cost auditor	within 180 days of FY start
audit, Table A: overall / Rule 3 products	₹50 cr / ₹25 cr	CRA-2	30 days of Board meeting or 180 days, earlier
audit, Table B: overall / Rule 3 products	₹100 cr / ₹35 cr	casual vacancy / CRA-2 after it	30 days / 30 days
exports exemption	> 75% of revenue	report to the Board	180 days from FY end
sectors: regulated / non-regulated	6 / 33	CRA-4 to the CG	30 days from receipt
Rules in force · latest amendment	30.06.2014 · 15 October 2019	renovation in a reconciliation (5-year life)	add 4/5th

Module 3 · The Cost Auditor P17 · topics 3.1–3.6

SM pp. 95–122. **66 marks in 7 papers. Q3(a), 7 marks, in every paper** (appointment and remuneration, KMP / independent director, qualifications and disqualifications, fraud reporting, steps before accepting, professional misconduct), plus 1–2 MCQs (10-year fraud bar, ADT-3, s.442 panel, 180 days).

Paper	Q3(a) long question · MCQs
Jun'23	Q3(a) **fundamental principles of professional ethics** (6) · MCQs: fraud reported under s.143(12); appointment within 180 days
Dec'23	Q3(a) **appointment and remuneration procedure** · MCQs: s.148(3); casual vacancy on death → 30 days
Jun'24	Q3(a) **cost accountant as KMP / independent director** · MCQ: fraud conviction → 10-year bar
Dec'24	Q3(a) **qualifications and disqualifications** · MCQ: what is not professional misconduct
Jun'25	Q3(a) **duty to report fraud** (= PTP Q3(a)) · MCQ: resigning auditor files ADT-3
Dec'25	Q3(a) **steps before accepting appointment** · MCQs: mediation and conciliation panel s.442; who cannot be appointed
Jun'26	Q3(a) **professional misconduct, First Schedule** of the CWA Act

DEC'26 PREDICTION · Q3(a), 7 MARKS, CERTAIN

- (1) **Eligibility: who is eligible and who cannot be appointed** (s.141 + Rule 10 + s.148; ICMAI MQP Q3(a)); (2) **fraud reporting** under s.143(12) again (PTP); (3) appointment and remuneration; (4) **rights and duties, removal** (never asked long).
- MCQs: 10 years · 20 companies · ₹1 lakh / ₹5 lakh / ₹1 lakh · 30 days · ADT-3 · s.143(12) penalty · s.447 / 448.
- Q3(a) can also be Module 1 or 6; Module 3 had it in all 7 papers.

MAP

1. 3.1 Who is a cost auditor ★
2. 3.2 Eligibility and disqualifications ★★★
3. 3.2 Appointment, remuneration, removal, resignation ★★★
4. 3.2 Rights, duties, CRA-3 report contents ★★
5. 3.2 Strategic positions (KMP, ID, tribunals) ★★
6. 3.2 Liabilities ★
7. 3.3 Professional ethics ★★
8. 3.4–3.6 Fraud reporting, s.447, s.448, misconduct ★★★
9. SM exercise · numbers

3.1 Definition

SM WORDS **"Cost auditor"** means a **Cost Accountant in practice**, as defined in clause (b), **who is appointed by the Board** [Rule 2(c)]. A Cost Accountant in practice: a member under s.2(1)(b) of the **Cost and Works Accountants Act, 1959** holding a valid **certificate of practice** (s.6(1)), incl. a **firm or LLP** of cost accountants [Rule 2(b)]. **s.22** of the CWA Act: "professional or other misconduct" includes any act or omission in the **Schedules** (an illustrative list). [SM 95]

3.2 Eligibility, qualifications, disqualifications · Dec'24 Q3(a), MQP Q3(a), Dec'25 MCQ

THE LEGAL ROUTE

- No separate sections for the cost auditor except **s.148**; **s.148(5)**: the qualifications, disqualifications, rights, duties and obligations of the financial auditor (ss.139–147) apply **so far as may be applicable**, read with the Companies (Audit and Auditors) Rules, the CRA Rules and the CWA Act. [SM 96]
- **Qualifications:** (1) a **cost accountant** [s.148(3)]; (2) member under the CWA Act holding a certificate of practice [s.2(28)]; (3)–(4) member = name on the Register; (5) satisfies **s.141** [Rule 6(1A)(b)]; (6) a **firm** may be appointed in its name if a **majority of its partners practising in India** are qualified; (7) only partners who are cost accountants act and sign for a firm or LLP. [SM 97–98]
- **No rotation**: s.139(3) rotation is only for statutory auditors; companies (e.g. PSUs) may rotate as policy (SM T/F 2). [SM 101]

NOT ELIGIBLE · s.141(3) + RULE 10 + s.148

a. a **body corporate**, other than an **LLP**;
b. an **officer or employee** of the company;
c. a **partner or employee of an officer or employee**;
d. he, his relative or partner: holds **securities or interest** in the company or its group (a **relative** may hold up to **₹1 lakh** face value); is **indebted** to it above **₹5 lakh**; has given a **guarantee or security** for a third person's debt to it above **₹1 lakh**;
e. a **business relationship** with the company or its group (except permitted professional services and arm's-length ordinary-course sales);
f. a **relative** is a director or KMP;
g. in **full-time employment elsewhere**, or auditor of **more than twenty companies**;
h. **convicted of an offence involving fraud** and **ten years** have not elapsed (Jun'24 MCQ; SM MCQ 13);
i. renders **s.144 services**: accounting and book-keeping, internal audit, financial information systems, actuarial,

investment advisory, investment banking, outsourced financial services, management services.

[SM 96–99]

A disqualification incurred after appointment → he **vacates office**; a **casual vacancy** [s.141(4), Rule 6(3A)]. The **statutory auditor** (s.139) cannot be the cost auditor [s.148(3)]. [SM 99]

3.2 Appointment, remuneration, removal, resignation · Dec'23 + Dec'25 Q3(a)

BEFORE written **consent** + **certificate** (Rule 6(1A)) → **BOARD** appoints within **180 days** of FY start, on the **audit committee's** recommendation → **CRA-2** 30 days of Board meeting or 180 days of FY, earlier → **FEE** Board approves; **shareholders ratify** → **TENURE** 180 days after FY end or till the report

[SM 99–101]

STEPS BEFORE ACCEPTING (DEC'25 Q3(a)) · RULE 6(1A) CERTIFICATE

a. he or the firm is **eligible and not disqualified** under the Act, the CWA Act and their rules;

b. satisfies the criteria of **s.141**, so far as applicable;

c. the appointment is **within the limits** laid down by the Act;

d. the **list of pending proceedings** on professional conduct against him, the firm or any partner is true and correct.

[SM 99]

Then **written consent**; the company informs him and files **CRA-2**. [SM 99]

REMUNERATION (RULE 14, AUDIT AND AUDITORS RULES) · DEC'23 Q3(a)

- **With an audit committee:** the Board appoints the cost auditor **on the audit committee's recommendation**, which also recommends his remuneration; the Board **considers and approves** it; the **shareholders ratify** it subsequently (SM T/F 5: True). [SM 101]
- **Without one:** the Board appoints; the **remuneration is ratified by the shareholders**. [SM 101]

REMOVAL, CASUAL VACANCY, RESIGNATION

- **Removal** before the term: by **Board resolution**, after a **reasonable opportunity of being heard**, with **reasons recorded in writing** (not by the audit committee: SM T/F 3); new CRA-2 with the resolution. [SM 100–101]
- **Casual vacancy** (resignation, death, removal): Board fills it within **thirty days**; CRA-2 within thirty days of the appointment (Dec'23 MCQ). [SM 100]
- **Resignation**: statement in **Form ADT-3** with the company and the registrar **within 30 days** [s.140(2), Rule 8] (Jun'25 MCQ); default: fine **₹50,000** to **₹2 Lakh**. [SM 100]

RIGHTS AND DUTIES (s.143 + s.148(5))

- s.143 applies *mutatis mutandis* to the cost accountant doing cost audit [s.143(14)]. The company gives **all assistance and facilities**; the auditor **complies with cost auditing standards**; report to the **Board**. [SM 102]
- **CRA-3 must state:** (a) all information and explanations obtained; (b) proper cost records kept per Rule 5; (c) adequate returns from **branches not visited**; (d) books give the information required; (e) adequate **internal audit of cost records**; (f) the annexure gives a **true and fair view** of cost of production, cost of sales, margin; (g) unit-wise and product-wise cost statements are kept. [SM 102]

3.2 Strategic positions for cost accountants · Jun'24 Q3(a) · liabilities

- **KMP (s.203)**: MD/CEO/manager (or whole-time director), company secretary, CFO; a cost accountant's credentials qualify him to be a **KMP**. [SM 104]
- **Independent director**: s.149(4) — at least **one-third** of the board of listed companies; Rule 5 needs expertise in finance, law, management, sales, marketing, administration, research, governance or technical operations → a cost accountant is eligible. [SM 104]
- **Technical member, NCLT** (s.409(3)): practising cost accountant of at least **fifteen years**; **NCLAT** (s.411(3)): over **25 years**. [SM 104]
- **Company liquidator** (s.275(2)) from the CG's panel (at least **10 years** of corporate experience) · **administrator** (s.259) · **expert** (s.2(38)); **SFIO** experts incl. **forensic audit** (s.211(2)) · **registered valuer** (s.247) · appear before **NCLT/NCLAT** (s.432) · **mediation and conciliation panel** (s.442: rules yet to be notified; Dec'25 MCQ). [SM 104–106]

LIABILITIES

- **Civil:** misstatement in prospectus as an expert (s.35); **misfeasance** at liquidation (s.340). [SM 106]
- **Criminal:** prospectus (s.34 → s.447); **s.147** breach of ss.139, 144, 145: fine **₹25,000** to **₹5,00,000** or **four times** remuneration, whichever less; wilful: up to **1 year** and **₹50,000** to **₹25,00,000** or **eight times**, whichever less, plus refund and damages; firm and partners jointly for fines. [SM 106–107]
- s.217 refusing documents to an inspector; s.336 fraud in winding up (**three to five years**); s.448 false statement → s.447; **s.449 false evidence**: three to seven years, fine up to ten lakh. [SM 107]
- Other Acts: Income-tax s.278; CWA Act Schedules; LIC Act s.104; BR Act s.46. **Contractual**: Contract Act; *Wilde v. Cape and Dalgeish* (1897). [SM 108]

3.3 Professional ethics · Jun'23 Q3(a)

The profession's objectives need four **basic needs**: (a) **credibility** in information and systems; (b) **professionalism**; (c) **quality of service**; (d) **confidence** in a framework of ethics. [SM 109]

In addition, a cost accountant in practice should **be and appear to be free** of any interest incompatible with integrity, objectivity and **independence**. [SM 109]

FIVE FUNDAMENTAL PRINCIPLES (SM WORDS)

a. **Integrity**: straightforward and honest.
b. **Objectivity**: fair; no prejudice, bias or influence of others.
c. **Competence**: refrain from a service he is not competent to do, unless proper advice and assistance is obtained.
d. **Confidentiality**: no disclosure or use without proper and specific authority or a legal or professional duty.
e. **Professional behaviour**: consistent with the good reputation of the profession.

[SM 109]

3.4–3.5 Duty to report fraud · s.447 · Jun'25 Q3(a), PTP Q3(a), Jun'23 MCQ

- SM WORDS **s.143(12)**: if an auditor, in the course of his duties, has **reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees**, he shall report it to the **Central Government** within the prescribed time and manner. [SM 110]
- Below the Rule 13 amount: report to the **audit committee** (s.177) or the **Board**; the company then discloses it in the **Board's report**. [SM 103–104]
- **s.143(13)**: no breach of duty if reported in **good faith**. **s.143(14)**: applies to cost accountants (s.148) and company secretaries (s.204). [SM 104, SM 110]
- Report **immediately but not later than 2 days** of his knowledge: (a) **nature** of fraud with description; (b) approximate **amount**; (c) **parties** involved. Board's report: (a)–(c) + **remedial action** taken. [SM 110]

⚠ PENALTY: THE SM GIVES TWO FIGURES

SM 110 (old s.143(15)): fine **one lakh** to **twenty-five lakh** rupees (SM MCQ 2 key: ₹25 lakh). SM 104 (as amended in 2020): **penalty ₹5 lakh** for a **listed** company, **₹1 lakh** for others. Write the amended figures and mention the old ones. [SM 104, SM 110, SM 122]

⚠ NOT IN THE SM: RULE 13 THRESHOLD AND FORM

Rule 13 of the Companies (Audit and Auditors) Rules: fraud of **₹1 crore or above** → report to the Central Government (Form **ADT-4**): to the Board / audit committee within **2 days**, their reply within **45 days**, then to the CG within **15 days**; below ₹1 crore → audit committee or Board within 2 days.

s.447 PUNISHMENT FOR FRAUD

- SM WORDS Imprisonment **not less than six months**, up to **ten years**, and fine **not less than the amount involved**, up to **three times** the amount; if **public interest** is involved, imprisonment **not less than three years**. [SM 111]
- Fraud of at least **ten lakh** rupees or **one per cent of turnover**, whichever is lower, gets that punishment; smaller frauds without public interest: up to **five years** or fine up to **fifty lakh** or both. [SM 106]
- **"Fraud"**: any act, omission, concealment of fact or abuse of position, with intent to **deceive, gain undue advantage, or injure** the company, its shareholders, creditors or others, **whether or not there is wrongful gain or loss**. [SM 111]

s.448 FALSE STATEMENT (MQP MCQ)

A statement in any return, report, certificate, financial statement, prospectus or other document that is (a) **false in any material particular, knowing it to be false**, or (b) **omits a material fact**, knowing it to be material → liable under **s.447** (SM fill-in 3). [SM 112]

3.6 Professional and other misconduct · CWA Act Schedules · Jun'26 Q3(a), Dec'24 MCQ

FIRST SCHEDULE · PART I · IN PRACTICE (JUN'26 Q3(a))

1. allows a non-cost-accountant to **practise in his name**;
2. **shares fees** or profits with a non-member (other than partners, retired partners, legal representatives);
3. **accepts profits** of the work of a non-member (except permitted arrangements);
4. enters **partnership** with persons other than cost accountants in practice or prescribed professionals;
5. **secures work** through non-employees or by means not open to a cost accountant;

SECOND SCHEDULE · PART I · IN PRACTICE

1. **discloses client information** without consent or legal requirement;
2. **certifies a report** not examined by him, a partner, an employee or another practising cost accountant;
3. lends his name to a **forecast** as if he vouched for it;
4. gives an opinion where he has a **substantial interest**;
5. fails to **disclose a material fact**;
6. fails to report a **material misstatement**;
7. lacks **due diligence** or is **grossly negligent**;

6. **solicits** clients by circular, advertisement, personal communication or interview (but may respond to **tenders** and invite work from other cost accountants);
7. **advertises** or uses designations other than "cost accountant" (a write-up per Council guidelines is allowed).

[SM 112–113]

Part II (in service): shares emoluments; accepts commission from the employer's lawyers, brokers, agents. **Part III (generally):** acts as a fellow when not one; does not supply information to the Institute; gives false information when inviting work. **Part IV (other misconduct):** held guilty for an offence punishable with imprisonment **not exceeding six months**; brings disrepute. [SM 113–114]

8. fails to obtain **sufficient information** for an opinion;
9. fails to point out **departures from accepted costing procedure**;
10. does not keep client money in a **separate bank account**.

[SM 114–115]

Part II: contravenes the Act or Council guidelines; discloses employer's confidential information; gives false particulars to the Institute; **defalcates or embezzles**. **Part III:** held guilty for an offence punishable with imprisonment **exceeding six months**. **Penalties:** s.24 falsely claiming membership, s.25 using the Institute's name: up to **one thousand** rupees; repeat up to six months / five thousand; **s.26** a **company may not practise** as cost accountants (SM fill-in 2); s.27 unqualified persons may not sign; s.29 prosecution only on a complaint of the Council or the CG. [SM 115–117]

SM SOLVED CASE · APPLICABILITY WITH SCRAP AND BY-PRODUCT (NON-REGULATED, TURNOVER ₹159 CRORE)

CTA 7401 waste and scrap ₹46 cr · 7405 product ₹57 cr · 7406 by-product ₹56 cr. Opinion: total turnover above **₹100.00 crores** and the main product above **₹35.00 crores** → records and audit apply, but **only to the main product (7405)**; scrap is not a product; a by-product sold as such is credited to the main product's cost; a separate statement is needed only if it is **further processed**. [SM 117–118]

EX The SM's own exercise (SM 119–122) · numbers

1 appointment under	**s.148(3)**	8 audit of efficiency, performance, propriety	**cost audit**
2 maximum fine, s.143(12) breach	**₹25 lakhs** (old; ⚠ above)	9 the 2014 Rules superseded	**Cost Accounting Records Rules, 2011**
3 fraud reported under	**s.143(12)** (= Jun'23 MCQ)	11 appointment for FY 2023-24	**by 27.09.2023**
4 appoint within ★	**180 days**	13 fraud conviction bar ★	**10 years**
5 report filed within (SM key)	**180 days** of FY end	fill-ins: rights and duties s.**143**; companies barred s.**26** CWA Act; false report s.**447**	relative's securities ₹**1** lakh; casual vacancy **30** days
6 officer not eligible	**s.141**	7 same powers as s.143 auditor	**s.148**

Rule	Number	Rule	Number
indebtedness / guarantee / relative's securities	> ₹5 lakh / > ₹1 lakh / > ₹1 lakh	s.447 term / public interest	6 months–10 years / ≥ 3 years
audit limit · fraud conviction bar	20 companies · 10 years	s.447 fine	≥ amount, ≤ 3 times
ADT-3 · fine	30 days · ₹50,000–₹2 lakh	fraud report to the Board	within 2 days
s.143(12) penalty (amended)	₹5 lakh listed / ₹1 lakh others	NCLT / NCLAT technical member	15 / 25 years
s.147: fine / wilful	₹25,000–₹5 lakh / ₹50,000–₹25 lakh	independent directors (listed)	one-third

Module 4 · Cost Accounting Standards, GACAP P17 · topics 4.1–4.3

SM pp. 125–286. **119 marks in 7 papers — the biggest module of P17.** Every paper since Dec'23 has **two CAS sums in Q4** (7 + 7) plus 2–6 MCQ marks ("CAS-x deals with", one rule). The Dec'26 supplementary adds **CAS-25 Valuation of Inventory** (Part 4). This module is printed in four packs: **1** overview + CAS 1–6 · **2** CAS 7–12 · **3** CAS 13–24 · **4** CAS-25, guidance notes, GACAP, the SM exercise, revision.

Paper	What was asked from the CAS	Marks
Jun'23	Q3(b) **CAS-2 capacity** sum: installed, practical, normal, idle, abnormal (old layout)	10
Dec'23	MCQs: CAS-17 deals with · idle time · not employee cost (CAS-7) · Q4(a) **landed cost of material, CAS-6** · Q4(b) **employee cost, CAS-7**	6 + 7 + 7
Jun'24	MCQs: CAS-12 · installed − normal = normal idle (CAS-2) · self-generated utilities (CAS-8) · Q4(a) **closing stock with normal/abnormal loss, CAS-6** · Q4(b) **cost of production for captive consumption, CAS-4**	6 + 7 + 7
Dec'24	MCQs: forex rate (CAS-6) · PF penalty (CAS-7) · not transport cost (CAS-5) · capacity % (CAS-2) · Q4(b) **employee cost, CAS-7** (Dec'23 repeated)	8 + 7
Jun'25	MCQ: CAS-5 deals with · Q4(a) **direct expenses, CAS-10** · Q4(b) **unit cost of production, CAS-4**	2 + 7 + 7
Dec'25	MCQ: CAS-8 · Q4(a) **imported material, CAS-6** · Q4(b) **insurance spare, CAS-12**	2 + 7 + 7
Jun'26	MCQs: service cost centre (CAS-13) · CAS-8 · stripping activity (CAS-23) · Q4(a) **captive power, CAS-8** · Q4(b) **direct expenses, CAS-10** (MQP data)	6 + 7 + 7

HOW IT IS EXAMINED · DEC'26 PREDICTION

- **Q4(a) + Q4(b): two CAS sums, certain** (11 of 12 halves since Dec'23). The rotation: CAS-6 material ×3, CAS-7 employee ×2, CAS-4 ×2, CAS-10 ×2, CAS-8 and CAS-12 ×1, CAS-2 in Jun'23.
- Our picks: (1) **CAS-25 inventory valuation** (new, never asked); (2) **CAS-7** employee cost (PTP Q4(b)); (3) **CAS-6** material; (4) **CAS-4**; (5) CAS-8, CAS-12 or CAS-2.
- **MCQs (2–3):** "CAS-x deals with" (learn the list on this page), one rule each from CAS-2, 5, 6, 7, 8 and a CAS-25 fact.
- Method of every sum: list each item → **include / exclude** with the CAS paragraph → total → per unit. The reason column earns the marks.
- **The SM's GACAP chapter has 16 solved illustrations** (SM 271–286); Jun'23 Q3(b) is Illustration 1 word for word, and the Jun'24, Dec'23, Dec'24, Jun'25, Jun'26 and Dec'25 sums are Illustrations 6, 8, 10, 11, 12, 14 and 15 with new figures. Practise all 16.

MAP OF THIS PACK

1. What a CAS is; utilities; structure; the list of 24 ★★★
2. CAS-1 Classification of cost ★
3. CAS-2 Capacity determination + sum ★★
4. CAS-3 Production and operation overheads ★
5. CAS-4 Cost of production (GST) + 2 sums ★★★
6. CAS-5 Transportation cost ★
7. CAS-6 Material cost + 3 sums ★★★
8. Numbers to learn

4.1 What a Cost Accounting Standard is

MEANING AND THE BOARD

SM WORDS Cost Accounting Standards are **guidelines for the companies** [for the management] that specify the **cost accounting treatment** for various cost elements, **minimum disclosure requirements** and ensure the **comparability, consistency, and completeness** of cost records. ICMAI constituted the **Cost Accounting Standards Board (CASB)** to formulate them. [SM 125]

Structure of every CAS: Introduction · Objective · Scope · Definitions · Principles of Measurement · Assignment of Cost · Presentation · Disclosure (+ effective date). The Institute has released **24** CASs. [SM 125]

UTILITIES OF CAS (SIX)

i. a **structured approach** to measurement of costs in manufacturing or service;
ii. **integrate, harmonize and standardize** cost accounting principles and practices;
iii. guidance for **uniformity and consistency** in classification, measurement, assignment and allocation;
iv. a basis for the cost of a product or service **where legal or regulatory bodies require it**;
v. let practising members use CAS in **attesting General Purpose Cost Statements**;
vi. a **clear and uniform understanding** for users, Government bodies, regulators, researchers and

Measurement = how an element is valued (commonly: no abnormal or imputed cost). **Assignment** = "cause and effect" or "benefits received"; trace directly where economically feasible. **Presentation** = separate head or part of a group. [SM 127]

academics.

[SM 125]

CAS	Title	Effective from	CAS	Title	Effective from
1	**Classification of Cost** (Rev. 2015)	1 April 2015	13	**Cost of Service Cost Centre**	1 April 2011
2	**Capacity Determination** (Rev. 2024)	1 April 2024	14	**Pollution Control Cost**	1 April 2012
3	**Production and Operation Overheads** (Rev. 2015)	1 April 2016	15	**Selling and Distribution Overheads**	1 April 2013
4	**Cost of Production / Acquisition / Supply of Goods / Provision of Service** (Rev. 2018)	1 March 2019	16	**Depreciation and Amortisation**	1 April 2014
5	**Average (Equalized) Cost of Transportation**	1 April 2010	17	**Interest and Financing Charges**	1 April 2014
6	**Material Cost**	1 April 2010	18	**Research and Development Costs**	1 April 2014
7	**Employee Cost**	1 April 2010	19	**Joint Costs**	1 April 2014
8	**Cost of Utilities**	1 April 2010	20	**Royalty and Technical Know-How Fee**	1 April 2014
9	**Packing Material Cost**	1 April 2010	21	**Quality Control**	1 April 2014
10	**Direct Expenses**	1 April 2010	22	**Manufacturing Cost**	1 April 2015
11	**Administrative Overheads**	1 April 2010	23	**Overburden Removal Cost**	1 April 2017
12	**Repairs and Maintenance Cost**	1 April 2010	24	**Treatment of Revenue in Cost Statements**	1 April 2017

SM 126–127. Guidance notes are listed only for CAS 6 to CAS 13; the CAS-2 (Revised 2024) note is "in process". New: **CAS-25 Valuation of Inventory** from 1 April 2026 (Dec'26 supplementary, Part 4). MCQs asked: CAS-17 (Dec'23, PTP), CAS-12 (Jun'24), CAS-5 (Jun'25), CAS-8 (Dec'25, Jun'26), CAS-13 (Jun'26).

MEMORY HOOK · THE 24 IN FOUR ROWS

1–6 the frame: Classify, Capacity, Overheads, Production (GST), Transport, Material · **7–12 the elements:** Employee, Utilities, Packing, Direct exp., Admin, Repairs · **13–18 the centres and charges:** Service centre, Pollution, Selling, Depreciation, Interest, R&D · **19–24 the specials:** Joint, Royalty, Quality, Manufacturing, Overburden, Revenue (+ 25 Inventory).

CAS-1 Classification of Cost (Revised 2015) · MCQ facts

KEY DEFINITIONS (PARA 4)

- **Classification of cost**: arrangement of items of costs in logical groups by their **nature (subjective classification)** and **purpose (objective classification)**. [SM 128]
- **Conversion cost** = production cost **excluding direct materials**. **Cost** = a measurement, in monetary terms, of resources used for production of goods or rendering services. [SM 128]
- **Cost centre**: any unit selected to accumulate cost (division, department, section, group of machines or of employees). Types: **personal / impersonal**; **operating / support-service**. [SM 129]
- **Cost of production** = materials consumed + direct employee costs + direct expenses + production overheads

MORE DEFINITIONS

- **Employee cost**: benefits paid or payable for services of employees, incl. temporary, part-time and contract employees (not a contractor's employees on a contract job). Past-period compensation by court order and prior-period short provisions = employee cost of the year but **not production cost**. [SM 130]
- **Marketing overheads** = selling + distribution overheads. **Overheads** = indirect materials + indirect employees + indirect expenses. [SM 131]
- **Normal capacity**: production achieved on an average over a number of periods under normal circumstances, allowing for planned maintenance. [SM 131]

+ **quality control** + **packing** + **R&D** + **administrative overheads relating to production**; adjust WIP, finished goods, scrap recoveries. [SM 129]
- **Cost of transportation**: freight, cartage, transit insurance, own fleet, incidentals — **not detention and demurrage**. [SM 129]
- **Cost unit**: Power MW · Cement MT · Automobile number · Transport tonne-km. [SM 129]
- **Direct expenses** (other than direct material and employee cost): royalties on production, job charges, hire of equipment for a job, job-specific software. [SM 129–130]
- **Distribution overheads**: from "ready for despatch" until it reaches the consumer: secondary packing, outward transport, warehousing, C&F charges. [SM 130]
- **Packing**: **primary** holds and preserves the product for use; **secondary** lets it be stored, transported, promoted. **Prime cost** = direct material + direct employee + direct expenses. [SM 131]
- **Production overheads** = factory = works = manufacturing overheads; include administration of the factory. [SM 131]
- **Support-service cost centre**: engineering, workshop, quality control, designing, laboratory, help desk. **Standard cost**: predetermined on technical specifications and efficient conditions. [SM 131–132]

Basis of classification (para 6)	Classes
1. by **nature** of expense	**Material · Employee · Expenses** (expenses e.g. utilities, bought-out services, job processing) [SM 133]
2. by **traceability**	**direct** (assignable in an economically feasible way) / **indirect**; e.g. indirect material = consumable spares, lubricants; indirect employee = security staff [SM 133–134]
3. by **function**	production/project · administration · selling · distribution · research · development [SM 134–135]
4. by **behaviour**	fixed · variable · semi-variable [SM 135]
5. by **production process**	batch · process · operation · contract · joint cost [SM 135]

Principles: group by similarity of nature, attributes or relations; the scheme must classify **every item**. **Presentation:** on the basis of relevant classification, **consistently** from period to period. **Change** only if required by law, a CAS, or for a more appropriate presentation; a material change is disclosed. [SM 132, SM 135]

CAS-2 Capacity Determination (Revised 2024) · Jun'23 sum, Jun'24 + Dec'24 MCQs

DEFINITIONS (REVISED 2024)

- SM WORDS **Installed capacity**: the **maximum capacity** of producing goods or providing services, according to the **manufacturer's specifications** or determined through an **expert study**. [SM 137]
- **Practical (achievable) capacity**: the maximum productive capacity reduced by the **predictable and unavoidable** interruptions from **internal causes** (maintenance, set-ups, weekly offs, holidays). External causes such as lack of orders are **not** deducted. [SM 136]
- **Normal capacity**: achieved or achievable on an **average over a number of periods** under normal circumstances. [SM 137]
- **Actual capacity utilization**: production achieved in a period, **expressed as a percentage of installed capacity** (Dec'24 MCQ). [SM 136]
- **Idle capacity** = installed − actual utilization (when actual is less). **Excess capacity utilization** = the same difference when actual is more. [SM 137]
- **Licenced capacity** = allowed or allotted by an authority. **Bottleneck** = the stage that restricts the flow (narrow neck of a bottle). [SM 136–137]

⚠ OLD vs NEW TERMS

CAS-4 (still in the SM) keeps the older pair: **normal idle capacity** = installed − normal; **abnormal idle capacity** = normal − actual, where actual is lower than normal. Jun'24 MCQ: installed − normal = **normal idle capacity**. [SM 147]

HOW EACH IS DETERMINED (PARA 5)

- In **units** of production or services, or **equivalent machine or man hours**. [SM 137]
- **Installed**, based on: (i) technical specifications; (ii) technical evaluation; (iii) capacities of individual or interrelated centres; (iv) critical machines; (v) shifts, machine or man hours. No specifications → **technical experts' estimate**; Government direction prevails; **bottlenecks** considered. [SM 137]
- **Practical** = installed adjusted for: (i) planned maintenance; (ii) shifts or hours; (iii) **holidays, weekly offs, normal shut-down, normal idle time**; (iv) batch change-over, set-up; (v) **ageing** of machines; (vi) other normal internal factors. [SM 137]
- **Reassess** installed capacity on any addition, deletion or modification, from the date of change. [SM 138]
- **Normal** = actual achieved or expected over a period, or average achievable; **average of three to five normal years**, excluding periods hit by abnormalities. Use **equivalence** for products of different sizes and intermediates; adjust for machines leased in or out. [SM 138]

Presentation: installed, normal and actual production **in absolute terms**; utilization **as a % of installed**. **Disclose:** (a) basis of each capacity; (b) changes with reasons; (c) capacity enhanced by outsourcing; (d) capacity outsourced to others; (e) actual production, in-house and outsourced; (f) **reasons for low utilization**; (g) **abnormal cost of under-utilization**. [SM 138]

MODEL ANSWER · CAPACITY UNDER CAS-2 (JUN'23 Q3(b), 10 MARKS = SM GACAP ILLUSTRATION 1 WORD FOR WORD; ICMAI POSTAL Q3(a) THE SAME)

Data: 1,500 units per machine hour; 3 shifts of 8 hours; 365 days; Sundays 52 and other holidays 12 (maintenance done in them); normal idle time 1 hour per shift; production of the last 5 years 75.70, 87.42, 65.38, 77.97, 76.08 lakh units; actual 81.50 lakh units.

Measure	Working	Lakh units
(i) Installed capacity	1,500 × 24 hours × 365 days (maximum, as per specification)	131.40
(ii) Practical capacity	working days 365 − 52 − 12 = 301; hours 3 × (8 − 1) = 21; 1,500 × 21 × 301	94.815
(iv) Normal capacity	average of 5 normal years: 382.55 ÷ 5	76.51
(iii) Actual capacity utilization	81.50 ÷ 131.40 (as a % of installed)	62.02%
(v) Idle capacity	131.40 − 81.50 = 49.90 lakh; ÷ 131.40	37.98%
(vi) Abnormal idle capacity	the SM solution: practical − actual = 94.815 − 81.50	13.315

Advice: the 13.315 lakh units lost below practical capacity are the capacity to recover (orders, maintenance); fixed overheads are absorbed on **actual** production, being higher than normal (CAS-4 para 5.27). Disclose the basis of each capacity and the reasons for low utilization. [SM 138, SM 151, SM 271–272]

⚠ Write (vi) as the SM solution does (practical − actual). By the CAS-4 definition (normal − actual) it would be nil here, because actual production is above normal; if you use it, say so. SM Illustration 4 (Glory Ltd) and 5 use the same method. [SM 147, SM 275–276]

CAS-3 Production and Operation Overheads (Revised 2015) · rules used in every sum

MEASUREMENT (PARA 5)

1. Procured resources: at **invoice or agreed price** incl. duties and taxes and directly attributable expenditure, **net of discounts (other than cash discounts)**, taxes and duties refundable or to be credited. [SM 140]
2. Others (e.g. a spare made in-house, an internal repair): at cost incurred — material, employees, expenses. [SM 141]
3. **Abnormal cost**, material and quantifiable → excluded. **Imputed cost** → excluded. [SM 141]
4. Variances: **normal** → part of overheads; **abnormal** → excluded. [SM 141]
5. **Subsidy, grant, incentive** → reduced from the cost it relates to. [SM 141]
6. **Fines, penalties, damages** to authorities or third parties → excluded. [SM 141]
7. **Credits or recoveries** → deducted; any excess over the overheads = **other income**. [SM 141]

Imputed cost = notional cost, not involving cash outlay. **Absorption rate** = overheads of the activity ÷ volume of activity (e.g. machine-shop overheads ÷ machine hours). [SM 139–140]

ASSIGNMENT, ABSORPTION, PRESENTATION

- Trace directly where economically feasible; otherwise **cause and effect** or **benefits received**. Stand-by facilities: on **expected** benefits. [SM 141]
- SM WORDS **Variable** overheads are absorbed on **actual production**; **fixed** overheads on **normal capacity**. [SM 141–142]
- Presented as a **separate cost head**, element-wise and behaviour-wise if material; **under- or over-absorption** goes to the **reconciliation statement**. [SM 142]
- **Disclose:** basis of assignment; overheads in **foreign exchange**; **related-party** resources; subsidies reduced; credits or recoveries; abnormal cost excluded; **unabsorbed** overheads. Only where material, significant and quantifiable; in the body, a foot note or a schedule. [SM 142]

CAS-4 Cost of Production / Acquisition / Supply of Goods / Provision of Services (Revised 2018) · Jun'24 + Jun'25 sums

WHY IT EXISTS · GST VALUATION

- Originally for **captive consumption** under the Central Excise Valuation Rules 2000 (CBEC circular of 13-2-2003). After **GST from 1 July 2017** it values supplies where the value is cost-based. [SM 143]
- s.15(1) CGST: transaction value between independent parties; s.15(4): otherwise Chapter IV of the CGST Rules.

THE TWO RULES THAT DECIDE THE SUMS

- **Cost of production** = materials consumed + direct wages and salaries + direct expenses + works overheads + **quality control** + **R&D** + **packing** + **administrative overheads relating to production**; adjust WIP and FG, recoveries for scrap. [SM 145]

Rule 27 non-monetary consideration; **Rule 28** distinct or related persons (proviso: **90%** of the recipient's resale price); **Rule 29** through an agent. [SM 143–144]

- SM WORDS **Rule 30**: value = **one hundred and ten percent of the cost of production** or acquisition of goods or of provision of services. **Rule 31**: residual method; for services the supplier may go straight to Rule 31. [SM 144]
- **Scope:** cost of (i) production, (ii) acquisition, (iii) supply of goods; (iv) provision of services; (v) value by open market value or like kind and quality. [SM 144]

WHAT IS EXCLUDED OR DEDUCTED (PARA 5)

- **Abnormal cost** (material, quantifiable) · **interest and finance costs** · **impairment loss** · **imputed costs** · **fines, penalties, damages, demurrage** → excluded. [SM 151]
- **Subsidy / grant / incentive** (from anyone other than the recipient) and grants shown as deferred income → deducted. **Credits or recoveries** → deducted. [SM 151]
- **Scrap**: realised or realisable value deducted; abnormal scrap = loss. Brand royalty is **not** cost; royalty for use of an asset or technology **is**. [SM 149–150]
- Free inputs from the recipient (net of ITC) and amortised free tools, dies, drawings → **included**. [SM 151]
- Forex: rate on the **date of the transaction**; later changes excluded. [SM 151]

- SM WORDS Cost shall be determined based on the **normal capacity or actual capacity utilization whichever is higher**; unabsorbed cost is **abnormal cost**. [SM 151]
- On a **normal cost** basis: ignore abnormal and non-recurring costs, abnormally low utilization, abnormal rejections, accidents, strikes, fires, unexpected court orders. [SM 152]
- Variable overheads on actual production; fixed overheads, QC, R&D and production admin on normal or actual, **whichever is higher**. [SM 152]
- **Joint products**: joint cost to split-off on physical units, equivalent cost or NRV at split-off. **By-products**: NRV credited to the main product. [SM 152]
- Miscellaneous income from production (e.g. sale of empty containers of raw material) is deducted. WIP valued at cost by stage of completion. [SM 152–153]

PRESENTATION AND CERTIFICATION

- Appendix-1 goods produced · 2 services · 3 goods acquired · 4 open market value / like kind and quality. [SM 153]
- Provisional certificate on budgeted or standard cost when true cost is not known at supply; final later, with a debit or credit note (s.34). [SM 153]
- **Periodicity:** turnover within the s.10(1) limit → **six month** statement; above it → **quarterly**; plus an **annual** one on audited accounts by **31st December** of the next year. [SM 153–154]
- Prepared by management, signed by a **KMP** (partner, proprietor); certified by a **Cost Accountant in practice**. Effective **1st March 2019**. [SM 154]

Line	Appendix-1: Statement of Cost of Production of taxable goods (the answer format)
1–14	Material (specify) · process materials · utilities · direct employee · direct expenses · consumable stores and spares · repairs and maintenance · quality control · R&D · technical know-how fee / royalty · depreciation / amortization · other production overheads · admin overheads relating to production · industry-specific operating expenses [SM 155–156]
15–18	Total (1 to 14) **±** WIP adjustment **−** credit for recoveries = **net amount** [SM 156]
19–22	**+** packing cost **+** free or concessional inputs from the recipient (net of ITC) **+** amortised free moulds, tools, dies = **Cost of Production** [SM 156]

MODEL ANSWER 1 · COST OF PRODUCTION FOR CAPTIVE CONSUMPTION AND GST VALUE (JUN'24 Q4(b) = SM ILLUSTRATION 6 WITH NEW FIGURES, ₹ '000) · 7 MARKS

Item	₹ '000	Treatment
Direct material 3,650 · direct wages and salaries 1,740 · direct expenses 550	5,940	prime cost, included
Indirect materials 730 · factory overheads 970	1,700	works overheads, included
Administrative overheads: 40% of 1,400 relating to production	560	only the production part; the other 840 excluded
Quality control 675 · R&D 700	1,375	part of cost of production
Interest on working capital 450	—	excluded (para 5.20)
Less: sale of scrap realised	(570)	recovery deducted (para 5.5)
Cost of production (CAS-4)	**9,005**	
Value for GST: Rule 30 = 110% of cost of production	**9,905.5**	**i.e. ₹99,05,500**

MODEL ANSWER 2 · UNIT COST OF PRODUCTION (JUN'25 Q4(b), ₹ LAKH, OUTPUT 1,430 MT) · 7 MARKS

Item (Appendix-1 order)	₹ lakh	Treatment
Material purchased 5,622 less railway demurrage 320	5,302	demurrage excluded (para 5.28)
Material from sister concern at cost	1,460	included; disclose as related party
Utilities 3,628 · direct employee 1,450 · direct expenses 860 · consumable stores and spares 1,425	7,363	included
Repairs and maintenance 550 less abnormal breakdown 140	410	abnormal cost excluded (para 5.19)
Depreciation 1,280 · other overheads 1,420 · admin overheads relating to production 660	3,360	included
Working capital interest 225	—	excluded (para 5.20)
Total (1 to 14)	**17,895**	
WIP adjustment	(360)	as given
Less: subsidy received for operations	(325)	deducted (para 5.25)
Add: packing cost	540	line 19
Cost of production · per MT (17,750 ÷ 1,430)	**17,750 · 12.41**	**≈ ₹12.41 lakh per MT**

CAS-5 Average (Equalized) Cost of Transportation · Dec'24 + Jun'25 MCQs

- **Objective:** uniformity in determining averaged / equalized transportation cost; prescribe the **records**; **transparency**. The Finance Act 2003 required certification of transport cost for the excise assessable value. [SM 163]
- **Scope:** any statute or purpose, e.g. excise deduction, **insurance claims**, **freight subsidy** (Fertilizer Industry Coordination Committee), administered prices, inward freight in purchases, freight in inventory hypothecated to banks. [SM 163]
- SM WORDS **Cost of Transportation** comprises the cost of **freight, cartage, transit insurance** and cost of **operating fleet** and other incidental charges, incurred internally or paid to an outside agency, but does **not include detention and demurrage charges**. [SM 164]
- **Inward** (materials received) vs **outward** (sale or delivery). **Cartage** = short-distance movement. **Depot** includes warehouses, godowns, yards, C&F agents. **Equalized cost** = average cost over a period. [SM 164]
- Own fleet records: drivers' wages, fuel, lubricants, amortised **tyres and battery**, repairs, depreciation, distance and trips. [SM 164]
- **Separate records:** inward and outward; factory to depot and beyond; to and from **job-workers**; **trading goods**; exempted and export goods; other modes (ship, air). [SM 165]
- **Treatment: inward** → cost of procurement of materials; **outward** → **cost of sale**. [SM 165]
- **Apportionment of outward cost, in order of priority:** (i) **weight**; (ii) **volume**; (iii) **tonne-km**; (iv) unit / equivalent unit; (v) value of goods; (vi) % of space used. Follow the basis **consistently**; factor in **distance** for the weighted average. [SM 165]
- **Abnormal and non-recurring cost** is not transportation cost: **penalty, detention, demurrage, abnormal breakdown**. [SM 166]
- **Cost sheets:** Appendix 1 own fleet (variable: drivers, fuel, consumables, tyres, spares, repairs; fixed: insurance, licence and permit fees, depreciation); Appendix 2 hired transport; Appendix 3 apportionment and average outward cost per unit. [SM 166–169]

*Dec'24 MCQ: "not part of the cost of transportation" → **demurrage charge** (= SM MCQ 4). Jun'25 MCQ: CAS-5 deals with **equalized cost of transportation**.*

CAS-6 Material Cost (Revised 2017) · 3 sums (Dec'23, Jun'24, Dec'25) + Dec'24 MCQ

VALUATION OF RECEIPTS (PARA 5.1)

1. SM WORDS Receipt at **purchase price including duties and taxes, freight inwards, insurance**, and other expenditure directly attributable to procurement (**net of trade discounts, rebates, taxes and duties refundable** or to be credited) that can be quantified with reasonable accuracy at the time of acquisition. [SM 172]
2. **Finance costs** of acquiring materials → **not** material cost. [SM 172]

ISSUES, SCRAP, ASSIGNMENT, DISCLOSURE

- Issues: on cost-flow assumptions — **FIFO, LIFO, weighted average** — consistently. At standard cost, **price variances** are part of material cost. Abnormal cost excluded. Transport inside material cost follows **CAS-5**. [SM 172–173]
- **Scrap / defectives:** normal rejects are included in material cost of goods made; **abnormal** scrap is treated as a **loss** after crediting its realisable value. [SM 173]

3. **Self-manufactured** materials: DM + DE + direct expenses + factory overheads + **production admin**; **exclude** other admin, finance cost and **marketing overheads**. Captive consumption → CAS-4. [SM 172]
4. Spares, stand-by and servicing equipment meeting the PPE definition → **depreciated**; otherwise inventory, costed when consumed. [SM 172]
5. **Normal loss** before the factory is **absorbed in the cost of the balance** materials (net of recoveries from suppliers, insurers, carriers). Normal shrinkage, evaporation, moisture before receipt → absorbed, with the quantity adjusted. [SM 172]
6. **Forex** at the rate on the **date of the transaction**; later changes up to payment are not material cost (Dec'24 MCQ). [SM 172]
7. **Demurrage, detention, penalty** → excluded. **Subsidy / grant / incentive** → reduced. [SM 172]

- Third-party processing to the buyer's specification → **material cost**; subcontracted operations → **direct expenses**. Catalysts, dies, tools, moulds → **amortised** over production benefited; indirect material with life over one year → over its useful life. [SM 173]
- **Presentation:** direct materials as raw materials, components, semi-finished goods, sub-assemblies; purchased **indigenous, imported, self-manufactured**. [SM 174]
- **Disclose:** quantity and rates of **major items** (= those forming **5%** of material cost); basis of valuation; changes; abnormal cost excluded; demurrage excluded; subsidy reduced; **related-party** purchases. [SM 174]

MODEL ANSWER 3 · COST OF IMPORTED MATERIAL (DEC'25 Q4(a)) · 7 MARKS

Item	₹	Treatment under CAS-6
Purchase $1,80,000 × ₹86.45 (rate on the date of import = date of the transaction)	1,55,61,000	para 5.1.7; the contract-date and payment-date rates are ignored
Import duty 5% of material cost	7,78,050	duty not refundable → included
Freight (inclusive)	1,50,600	freight inwards included
Demurrage for delayed clearance 75,000	—	excluded (para 5.1.8); disclose
Bank charges for letter of credit 30,000	—	finance cost, excluded (para 5.1.2)
Less: import subsidy	(3,00,000)	reduced (para 5.1.9)
Cost of imported material	**1,61,89,650**	

⚠ No ICMAI suggested answer seen yet. If the examiner treats LC charges as directly attributable procurement cost, the total becomes ₹1,62,19,650; state the assumption in the answer.

MODEL ANSWER 4 · VALUE OF CLOSING STOCK, AVERAGE COST (JUN'24 Q4(a) = SM ILLUSTRATION 10 WITH NEW FIGURES) · 7 MARKS

Item (SM layout)	Units	₹	Treatment
Opening stock of raw materials	5,000	3,60,000	
Add: purchases	17,500	14,00,000	
Add: freight inwards		1,05,000	included (para 5.1.1)
Less: abnormal loss (moisture before receipt) = (14,00,000 + 1,05,000) × 100 ÷ 17,500	(100)	(8,600)	excluded; valued on purchase cost only
Less: normal loss in transit, 1% of 17,500	(175)	—	quantity only; cost absorbed (para 5.1.5)
Add: self-made packing for purchased materials (1,00,000 − 12,000)		88,000	marketing admin share excluded (para 5.1.3)
Demurrage 14,000		—	excluded (para 5.1.8)
Cost of raw materials available	**22,225**	**19,44,400**	**average ₹87.49 per unit**
Closing stock = 19,44,400 ÷ 22,225 × 3,500	**3,500**	**3,06,205**	

⚠ The SM's Illustration 10 divides by 22,325 (it forgets to take out the 100 abnormal units, though its own table shows 22,225); with that slip this answer would be ₹3,04,833. Divide by the units actually available. [SM 279–280]

MODEL ANSWER 5 · LANDED COST OF MATERIAL (DEC'23 Q4(a)) · 7 MARKS

Item	₹	Treatment
Purchase of materials (inclusive of GST)	4,00,000	
Less: GST 20,800	(20,800)	input tax credit available → deducted
Add: fee on board 18,000 · import duty 12,000 · freight inward 22,000 · insurance 12,000	64,000	directly attributable → included
Less: rebates	(6,000)	trade rebate deducted
Cash discount 4,000	—	a finance item, not deducted
Less: Government subsidy for the import	(22,000)	reduced (para 5.1.9)
Landed cost (value of receipt)	**4,15,200**	

This is the method of SM Illustration 8 ("Free on Board" is added; cash discount not deducted, being a financial item; GST input tax credit, rebates and subsidy deducted). [SM 278–279]

R Numbers to learn · Part 1

Rule	Number	Rule	Number
CAS issued (SM) · CAS-25 new	24 · 25	Rule 30 GST value	110% of cost
CAS-1 effective	1 Apr 2015	Rule 28 proviso (resale)	90% of price
CAS-2 (Revised 2024) effective	1 Apr 2024	CAS-4 effective	1 Mar 2019
CAS-3 (Revised 2015) effective	1 Apr 2016	CAS-4 statements: small / large / annual	6-monthly / quarterly / by 31 Dec
CAS-5, 6 effective	1 Apr 2010	CAS-6 major item	5% of material cost
normal capacity: average of	3 to 5 normal years	GST in force	1 Jul 2017

Ranking of outward-freight bases: weight → volume → tonne-km → unit → value → space. Fixed overheads: CAS-3 on **normal** capacity; CAS-4 on normal or actual, **whichever is higher**.

Module 4 · Part 2 · CAS-7 to CAS-12 the cost elements

SM pp. 175–201. **Six Q4 sums in seven papers came from this part**: CAS-7 employee cost (Dec'23, Dec'24, ICMAI PTP), CAS-10 direct expenses (Jun'25, Jun'26 = ICMAI MQP), CAS-8 captive power (Jun'26), CAS-12 insurance spare (Dec'25). MCQs: idle time, items not in employee cost, PF penalty, self-generated utilities, "CAS-8 deals with" (twice), "CAS-12 deals with".

HOW IT IS EXAMINED · DEC'26

- **CAS-7 is the best bet for a Q4 half**: asked as a sum in Dec'23 and Dec'24 with the same list of items, and again in ICMAI's Jun'26 PTP. The marks are in the **"not included" list with reasons**.
- **CAS-10**: royalty, design, software, hire charges per product (ICMAI's own MQP answer is copied below).
- **CAS-8**: cost per unit of captive power: fuel, water, wages, depreciation, repairs; exclude admin share; credit ash; divide by units **net of auxiliary consumption**.
- MCQs: CAS-7 definitions (idle time, overtime premium), what is excluded, which CAS deals with utilities / repairs.

MAP OF THIS PACK

1. CAS-7 Employee cost + 2 sums ★★★
2. CAS-8 Cost of utilities + captive power sum ★★
3. CAS-9 Packing material cost ★
4. CAS-10 Direct expenses + 2 sums ★★★
5. CAS-11 Administrative overheads ★
6. CAS-12 Repairs and maintenance + insurance-spare sum ★★
7. The common "exclude" list · numbers

THE SAME SIX EXCLUSIONS IN EVERY ELEMENT CAS

A-I-F-P-S-C: Abnormal cost · **I**mputed cost · **F**inance cost · **P**enalties and damages · **S**ubsidy reduced · **C**redits / recoveries deducted. Then: normal variances in, abnormal out; disclose related-party and foreign-exchange items.

CAS-7 Employee Cost (Revised 2017) · Dec'23 + Dec'24 sums, 3 MCQs

DEFINITIONS

- SM WORDS **Employee cost**: employee benefits paid or payable in **all forms of consideration** given for the services rendered by employees (including **temporary, part time and contract employees**) of an entity. [SM 176]
- **Explanation:** (1) contract employees = engaged **directly by the employer** on contract; **not** employees of a contractor; (2) **past-period compensation** on disputes or court orders is **not** employee cost; (3) **prior-period short provisions** made up now are **not** employee cost of the current period. Cash or kind both count. [SM 176]
- Includes: salaries, wages, allowances, bonus, incentives; PF and other funds; welfare; **future benefits** (gratuity, leave encashment, VRS / deferred cost); benefits: paid holidays, **leave with pay**, insurance, workmen's compensation, **medical benefits to employees and dependents**, free or subsidised food, housing, education, canteen, crèches, conveyance, LTC, interest-free loans, **cost of employees' stock option**. [SM 176–177]
- SM WORDS **Idle time**: the difference between the time for which employees are paid / payable and the employees' time booked against cost objects (Dec'23 MCQ). **Abnormal idle time**: strikes, lockouts, accidents. **Overtime premium**: the extra paid beyond normal wages for hours beyond normal. [SM 175, SM 177]

MEASUREMENT (PARA 5)

1. **Gross pay** incl. all allowances + cost to the employer of all benefits.
2. **Bonus** (statutory minimum or sharing of surplus) and **ex gratia** → employee cost.
3. **Managerial personnel incl. executive directors** → employee cost, even if a % of profits. **Non-executive directors** → **administrative overheads**.
4. **Separation costs** (VRS, retrenchment, termination) → **amortised** over the period benefitting.
5. No **imputed** costs. Idle time cost = idle hours × hourly rate.
6. Standard cost: normal variances in, abnormal variances → abnormal cost.
7. **Subsidy** reduced · **abnormal cost** excluded · **penalties, damages** to authorities excluded (Dec'24 MCQ: PF penalty → **excluded**).
8. Free housing, conveyance: at total cost of resources; **recoveries** from employees reduced.

[SM 177–178]

Assignment: by time or number of employees; else on time-study estimates. Amortised separation cost = **indirect**; the **unamortised amount of discontinued operations is not employee cost**. **Recruitment and training** = overheads. Overtime premium and idle time: direct or overheads, by economic feasibility and the cause. [SM 178–179]

Presentation: direct employee cost as a **separate head**; indirect within the overheads of each function; category-wise detail (permanent, temporary, part-time, contract, piece rate, overtime, benefits). **Disclose:** cost charged to **capital works**; **separation costs**; abnormal cost excluded; penalties excluded; subsidy reduced; **related-party** employee cost; cost in **foreign exchange**. [SM 179]

MODEL ANSWER 1 · EMPLOYEE COST UNDER CAS-7 (DEC'23 Q4(b) · DEC'24 Q4(b) REPEATED IT) · 7 MARKS

Item (₹ lakh)	Dec'23	Dec'24	Treatment and reason
Salary, wages and other allowances	1,700	825	included: gross pay (para 5.1)
Bonus	210	120	included (para 5.2)
Contribution to provident fund	190	100	included: employer's cost of benefits
Employees' welfare	140	45	included
Remuneration of full-time (executive) director	85	—	included (para 5.3)
Employee cost as per CAS-7	**2,325**	**1,090**	
Not included — wages to **contractor's employees** 350 / 110 (expl. 1 to para 4.7) · **abnormal cost due to strike** 128 / 85 (para 5.9) · **VRS for closure** of a section 112 / 67 (discontinued operation, para 6.4) · **compensation for past periods** under a court order 225 / 60 (expl. 2) · **arrear salary of the earlier year** 97 / 220 (expl. 3).			

This is SM GACAP Illustration 11 (₹980 lakh), which ICMAI reused as PTP Jun'26 Q4(b). GACAP adds: pay for the **lay-off period, strike period or suspension** is not cost (SM MCQ 7 and Dec'23 MCQ: "compensation for lay-off period" is not employee cost). [SM 262, SM 280–281]

ICMAI's PTP Jun'26 answer uses exactly this list ("will not be included: VRS paid for closure of an unit, abnormal cost, arrear salary not related to the current year, compensation paid against past periods, wages paid to contractor employees") and arrives at 750 + 90 + 40 + 100 = ₹980 lakh.

CAS-8 Cost of Utilities (Revised 2017) · Jun'26 sum; Jun'24, Dec'25, Jun'26 MCQs

- SM WORDS **Utilities**: significant inputs such as **power, steam, water, compressed air** and the like which are used for the manufacturing process but **do not form part of the final product**. [SM 181]
- **Not applicable** to entities whose main business is producing and selling utilities; does **not** cover **carbon credits**. Captive use for excise valuation → CAS-4. [SM 180]
- **Stand-by utilities**: backup against failure of the main source. **Committed cost**: cost of keeping stand-by utilities operational. Normal capacity of a **stand-by** utility = its **actual production**; of a captive utility = the normal capacity of the consuming plant. [SM 180–181]
- Each type of utility is a **distinct cost object**. Purchased: purchase cost incl. duties, transport, insurance, net of trade discounts and refundable taxes. [SM 181]

Self-generated for	Cost comprises
own consumption (Jun'24 MCQ)	DM + DE + direct expenses + **factory overheads** [SM 181]
inter-unit transfer	the above + **distribution cost** [SM 181]
inter-company transfer	+ distribution + **share of administrative overheads** [SM 182]
sale to outside parties	+ distribution + admin + **marketing overheads** (price adds the margin) [SM 182]

- No **finance costs**; **includes distribution cost** up to the point of consumption; no imputed costs. [SM 182]
- Standard cost: **price variances** and normal usage variances form part of cost; abnormal usage variances → abnormal cost. [SM 182]
- SM WORDS Cost of production and distribution of utilities on the **normal capacity or actual capacity utilization whichever is higher**; unabsorbed cost = abnormal cost. A stand-by utility includes its **committed costs**. [SM 182]
- Subsidy reduced; abnormal cost, penalties excluded; **credits / recoveries** (incl. utilities supplied outside) deducted. [SM 182]
- **Assignment:** trace directly; else the most appropriate basis, derived from **usage parameters**. [SM 182–183]
- **Presentation:** a separate head **for each type of utility**; separate utility statements classify **purchased / generated** with quantities by consuming unit, inter-unit, inter-company and outside sales. [SM 183]
- **Disclose (10):** basis of distribution; cost of purchase, production, distribution, marketing and price for outside sales; price and usage variances; related-party; inter-unit and inter-company transfers; foreign exchange; subsidy; credits; abnormal; penalties. [SM 183]

MODEL ANSWER 2 · COST PER UNIT OF CAPTIVE POWER (JUN'26 Q4(a), ONE MONTH) · 7 MARKS

Item	Working	₹
Coal	450 MT × 26,000	1,17,00,000
Furnace oil	10 MT × 1,35,000	13,50,000
Water	9 lakh litres × 2.75	24,75,000
Wages, generating plant	120 × 34,000 + 180 × 24,000	84,00,000
Wages, boiler plant	90 × 29,000 + 140 × 22,000	56,90,000
Depreciation, boiler	(80 − 8) lakh ÷ 12 years ÷ 12 months	50,000
Depreciation, generating plant	1.5 crore × 10% ÷ 12 months	1,25,000
Repairs and maintenance	factory overhead	8,00,000
Administrative overhead (share) 25 lakh	excluded: own-consumption utility = DM + DE + direct exp. + factory OH only (para 5.2.1)	—
Less: sale of ash	credit / recovery (para 5.11)	(3,00,000)
Net cost of power for the month		**3,02,90,000**
Units available for use	160 lakh − 5% auxiliary consumption (8 lakh)	152 lakh units
Cost per unit of power	**3,02,90,000 ÷ 1,52,00,000**	**₹1.99**

⚠ THE SM'S OWN ILLUSTRATION 12 DOES IT DIFFERENTLY

Jun'26 Q4(a) is SM Illustration 12 with new figures. The SM solution **includes the share of administrative charges** and charges a **full year's depreciation** against one month's units. Done that way, Jun'26 gives ₹3,47,15,000 ÷ 152 lakh = **₹2.28** per unit. The answer above follows the CAS: own-use utility = DM + DE + direct expenses + factory overheads (para 5.2.1; the Jun'24 MCQ answer) and one month's depreciation. In the exam write the CAS answer and add one line naming both treatments. [SM 181, SM 281–282]

CAS-9 Packing Material Cost (Revised 2017) · SM short essay: secondary packing

- **Packing materials**: used to hold, identify, describe, store, protect, display, transport, promote and make the product marketable. Classified as **primary** and **secondary**. [SM 184, SM 186]
- SM WORDS **Primary**: essential to **hold and preserve the product for its use by the customer** — foils and vials (pharma), gas cylinders, butter paper and wrappers. **Secondary**: enables to **store, transport, inform the customer, promote** — cartons and boxes for strips, boxes for yarn cones, jars of wrapped chocolates. [SM 186]
- **Reusable packing**: used more than once; cost assigned over the number of uses or period. **Packing material development cost**: pilot and field tests, consumer research, final evaluation. [SM 186–187, SM 188]
- Imputed cost example: packing material **supplied by the customer**. Abnormal cost example: packing rejected after issue for **misprinting** or wrong specification. [SM 184–185]
- Receipts: as CAS-6 (purchase price + duties, freight, insurance, net of trade discounts and refundable taxes); no finance costs; forex at the transaction date; demurrage excluded; subsidy reduced. [SM 187–188]
- **Self-manufactured**: DM, DE, direct expenses, **job charges**, factory overheads incl. factory admin, and the share of **R&D for improving** the existing process or product. [SM 187]
- Issues on FIFO, LIFO, weighted average, consistently. **Normal loss** on issue is part of packing cost; abnormal cost excluded; normal scrap credits deducted. [SM 188]
- SM WORDS **Cost of primary packing materials shall form part of the cost of production. Cost of secondary packing materials shall form part of distribution overheads.** [SM 188]
- **Presentation:** primary / secondary; then purchased indigenous, imported, self-manufactured; by type of pack (bale, bag, carton, pallet). [SM 189]

CAS-10 Direct Expenses (Revised 2017) · Jun'25 + Jun'26 sums (Jun'26 = ICMAI MQP data)

- SM WORDS **Direct expenses**: expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object **other than direct material cost and direct employee cost**. [SM 190]
- An item that fails **materiality** may be treated as **overheads**. [SM 192]
- No finance costs; no imputed costs (captive consumption → CAS-4); normal variances in; subsidy reduced; abnormal portion, penalties excluded; credits deducted. [SM 192]

- **Examples: royalties** linked to production; **job charges**; **hire charges** of equipment for a job; **design or drawing** for a job; **software** for a job; **travel** for a designated job. [SM 190]
- Identified on **traceability**. Bought-out resources at invoice price incl. duties, net of trade discounts and refundable taxes; others at the amount incurred (e.g. in-house dies and tools: DM, DE, direct expenses, factory overheads). R&D traceable to improving an existing product = direct expense. [SM 191]
- SM WORDS **Lump-sum or 'one-time' payments** (royalty, know-how, design fees) are **amortised on the estimated output or benefit**. [SM 191–192]
- **Assignment:** directly to the cost object. **Presentation:** a separate head if material, e.g. **subcontract charges**, **royalty on production**. [SM 192]
- **Disclose (10):** basis of distribution; quantity and rates; variances; procured vs generated; related-party; foreign exchange; subsidy; credits; abnormal portion; penalties. [SM 192–193]

SM exercise MCQ 16: design 20 + software 15 + travel 7 = 42 lacs; finance charges on a design lease are excluded. [SM 290–291]

MODEL ANSWER 3 · DIRECT EXPENSES PER PRODUCT (JUN'26 Q4(b) · SAME METHOD AS ICMAI'S MQP ANSWER) · 7 MARKS

Item (₹)	Basis	Product X	Product Y
Royalty paid on sales	units sold × ₹3: 1,75,000 / 1,50,000	5,25,000	4,50,000
Royalty paid on production	units produced × ₹1: 2,50,000 / 1,75,000	2,50,000	1,75,000
Hire charges of special equipment	used for Y only	—	75,000
Design charges	traced to each product	1,60,000	1,90,000
Software development charges	traced to each product	2,00,000	2,50,000
Direct expenses (CAS-10)	**total ₹22,75,000**	**11,35,000**	**11,40,000**

Jun'25 Q4(a), same method (royalty ₹2.50 per unit sold and ₹1.25 per unit produced; hire ₹60,000 for AB only): AB = 4,45,000 + 2,75,000 + 60,000 + 1,68,000 + 2,82,000 = **₹12,30,000**; AC = 3,65,000 + 2,22,500 + 1,90,000 + 3,87,000 = **₹11,64,500**. Machine hours are not needed (no common item to apportion).

⚠ ICMAI's own MQP answer and SM Illustration 14 (Troma Ltd = Jun'25 Q4(a) with new figures) both include royalty on sales in direct expenses, so follow them. [SM 283–284] But CAS-22 says "royalty paid on sales shall not form part of manufacturing cost" and CAS-20 sends brand royalty to cost of sales; if the question asks for cost of production, leave sales royalty out and say why. [SM 232, SM 240]

CAS-11 Administrative Overheads (Revised 2017)

- **Administrative overheads**: cost of all activities relating to **general administration and management**; they **exclude** production overheads (incl. factory administration), marketing overheads and finance costs. [SM 194]
- Measured as the aggregate of resources consumed in general management: **shared services, infrastructure, general management** — employee costs, utilities, office supplies, legal expenses, outside services, each measured by its own CAS. [SM 195]
- **Leases**: operating lease → entire rentals in admin overheads; **finance lease** → the finance portion goes to finance costs. [SM 195]
- **Software** (in-house, purchased, licensed, customised) incl. upgrades → **amortised over its estimated useful life**; use compatible lives for hardware upgraded with it. [SM 195]
- Outside services at invoice price net of discounts (other than **cash discount**); subsidy reduced; **abnormal** admin cost excluded (e.g. a **natural calamity**); fines and penalties excluded; credits deducted. [SM 195]
- **Assignment:** cause and effect or benefits received; shared services by **actual usage**; shared infrastructure by **readiness to serve**; general management on a logical basis such as **number of employees, turnover, investment**. [SM 196]
- **Presentation:** a separate cost head; component-wise if material. **Disclose:** basis of assignment; **imputed cost included**; foreign exchange; related parties; subsidy; credits; abnormal; penalties. [SM 196]

CAS-12 Repairs and Maintenance Cost (Revised 2017) · Dec'25 sum, Jun'24 MCQ

- SM WORDS **Repairs and maintenance cost**: cost of all activities which have the objective of **maintaining or restoring an asset** in or to a state in which it can perform its required function at **intended capacity and efficiency**. Covers **routine or preventive**, **planned** (predictive or corrective) and **breakdown** maintenance. [SM 198]
- **Major overhaul**: periodic (generally **more than one year**) repair to substantially restore the asset; its cost is **amortized on a rational basis**. [SM 198, SM 200]
- No finance costs, no imputed costs; price variances and normal usage variances in; subsidy reduced. [SM 200]
- **Abnormal** R&M (major **fire, explosion, flood**) excluded; **fines and damages** (e.g. penalty for wrongful construction) excluded; credits deducted. [SM 200]
- **Assignment:** trace directly; else cause and effect or benefits received; shared costs (incl. reciprocal services) distributed as per **CAS-3**. [SM 200]

- Cost = direct (materials, stores, spares, manpower, equipment usage, utilities) + indirect (common resources). In-house, contractor inside the entity, or at the contractor's premises: the contractor's charges plus own resources supplied. [SM 198–199]
- Each type of maintenance and each **major asset category** measured separately. [SM 199]
- **Spares replaced** that do not enhance future benefits beyond the earlier standard → R&M cost. **High-value spare** replaced and **reconditioned** → PPE if it meets the definition (depreciated); otherwise inventory. [SM 199]

- **Disclose:** basis of assignment; variances; **in-house vs contracted**; **major overhauls by asset type with the amortization method**; related-party; foreign exchange; subsidy; credits; abnormal; penalties. [SM 201]

MODEL ANSWER 4 · INSURANCE SPARE (DEC'25 Q4(b) = THE SM EXAMPLE AND ILLUSTRATION 15 WITH EVERY FIGURE DOUBLED) · 7 MARKS

Treatment: the insurance spare meets the PPE definition, so it is capitalised and depreciated from when it is available for use; the **reconditioned old spare** is restated at its current market value, and the **rest of its book value is charged to repairs and maintenance** (para 5.8). [SM 199]

₹ crore	SM example	Dec'25
A. Equipment cost + B. cost of new (insurance) spare	10.00 + 1.00 = 11.00	20.00 + 2.00 = 22.00
Depreciation for 5 years → depreciated value of equipment and spare	5.50	11.00
Reconditioning cost of old spare	0.10	0.20
Depreciated value of old spare	0.50	1.00
Book value of reconditioned spare	0.60	1.20
Less: current market value to be restated in the books	0.25	0.50
Amount treated as repairs and maintenance	**0.35 (₹35 lakh)**	**0.70 (₹70 lakh)**

R Numbers and traps · Part 2

Item	Answer	Item	Answer
contractor's employees' wages	**not** employee cost	executive / non-executive directors	employee cost / admin overheads
past-period court compensation, arrears	**not** current employee cost	VRS (continuing / closure)	amortised / excluded
ESOP cost, leave with pay, medical	employee cost	recruitment, training	overheads
PF penalty	excluded	gross pay vs TDS	gross (SM MCQ 13)
self-generated utility (own use)	DM + DE + DExp + factory OH	utility cost basis	normal or actual, higher
primary / secondary packing	production cost / distribution OH	major overhaul	more than one year; amortized
one-time royalty, know-how, design	amortised on output	operating / finance lease rentals	admin OH / finance part out

Module 4 · Part 3 · CAS-13 to CAS-24 MCQ standards

SM pp. 202–253. **No Q4 sum has come from these twelve yet**; they give MCQs: CAS-17 "deals with" (Dec'23, ICMAI PTP, SM MCQ 1), CAS-13 service cost centre (Jun'26), CAS-23 stripping activity (Jun'26), CAS-14 fines (SM true/false). Learn one card per standard: its **definition in SM words**, the **special rule** that makes it different, and its **effective date**. CAS-19 joint costs and CAS-24 revenue also feed the CAS-4 and reconciliation sums.

WHAT EACH ONE IS REMEMBERED FOR

13 service cost centre	usage-based distribution; not utilities or repairs
14 pollution control	future remediation in; social costs out; fines out
15 selling and distribution	long-benefit costs amortised; installation = production
16 depreciation	idle asset = abnormal; revaluation out; intangibles ≤ 10 years
17 interest	separate line under cost of sales; never product cost
18 R&D	improvement of existing product → cost of production
19 joint costs	physical units, NRV at split-off, technical estimates
20 royalty	mining royalty = material cost; brand = cost of sales
21 quality control	prevention + appraisal; benefits received (no. of tests)
22 manufacturing cost	excisable goods; royalty on sales excluded
23 overburden	charged at the standard stripping ratio
24 revenue	other income kept out of cost profit

THE COMMON PATTERN (SAVES READING TIME)

Every CAS here repeats the CAS-3/CAS-7 pattern: aggregate of **direct and indirect** cost · procured items at invoice price net of discounts (other than **cash** discount) and refundable taxes · **no finance cost, no imputed cost** · subsidy reduced · **abnormal** and **penalties** out · credits deducted · normal variances in · assign by **traceability**, else **cause and effect** or **benefits received** · separate cost head if material · disclose basis, related parties, foreign exchange, subsidy, credits, abnormal, penalties, and any change in principles.

MEMORY HOOK

"**S**ervice **P**ollutes **S**ales; **D**epreciation **I**nterests **R**esearch; **J**oint **R**oyalty **Q**uality **M**anufactures **O**verburden **R**evenue" = 13 → 24 in order.

CAS-13 Cost of Service Cost Centre (Revised 2017) · Jun'26 MCQ

- Covers service cost centres; **not** utilities (**CAS-8**) or repairs and maintenance (**CAS-12**). [SM 202]
- SM WORDS **Support-service cost centre**: the cost centre which primarily provides **auxiliary services across the entity** — to production, operation or other service centres, not directly engaged in manufacturing; sometimes to outside parties. **Examples:** engineering, workshop, R&D, quality control, designing, laboratory, welfare, safety, transport, tool stores, pollution control, computer cell, dispensary, school, crèche, township, security. [SM 203]
- **Stand-by service**: backup against failure of the main source; its cost includes **committed costs**. [SM 203–204]
- Each identifiable service cost centre is a **distinct cost object**, subject to materiality. [SM 203–204]
- Cost to others: **inter-unit** + distribution cost; **inter-company** + distribution + administrative overheads; **outside parties** + distribution + admin + **marketing overheads**. [SM 204]
- On **normal capacity or actual utilization, whichever is higher**; unabsorbed = abnormal. Charges to outside parties are **credits** reducing the cost. [SM 204]
- **Distribution** to consuming centres on logical parameters related to **usage**: equitable, reasonable and consistent. Presented as a separate head **for each type of service**. [SM 205]

CAS-14 Pollution Control Cost (Revised 2017) · SM true/false 3

- SM WORDS **Pollution control** means the control of **emissions and effluents** into environment: materials, processes or practices to **reduce, minimize, or eliminate** pollutants or wastes, incl. reducing toxic materials, energy and water use. [SM 207]
- Definitions from the **Air Act 1981** (air pollutant incl. **noise**), the **Environment (Protection) Act 1986**
- Each type (water, air, soil) a distinct activity. [SM 208]
- SM WORDS **Fines, penalties, damages** to authorities or third parties are **not** pollution control cost (SM T/F 3: a fine to the State Pollution Control Board → **False**). [SM 209]
- **R&D** for new processes to avoid pollution → R&D cost; **commercial development** of them → pollution control

(environment = water, air, land and their inter-relationship) and the **Water Act 1974**; soil pollution = a pollutant above its threshold. [SM 206–207]
- Internal costs at **historical cost** when incurred. **Future remediation or disposal** costs reasonably certain (onerous contract, constructive obligation) are **estimated per period**, e.g. per tonne of solid waste. **Contingent** costs from future legislation are **not** cost until reasonably certain. [SM 208]
- **External / social costs** are excluded from general-purpose cost statements. [SM 208]

cost. [SM 209]
- Trace to products by the **quantity of pollutant** each generates; ISO 14000 certification and registration fees → overheads. [SM 209]
- **Presentation:** classified as (a) direct / indirect, (b) **internal / external**, (c) **current / future**, (d) **domain**: water, air, soil. Disclose prior-period costs, basis of future estimates, and a reference to any social-cost note. [SM 210]

CAS-15 Selling and Distribution Overheads · effective 1 April 2013

- **Distribution overheads**: from **ready for despatch** until it reaches the **ultimate consumer** (incl. inter-unit transfers): packing or labelling at an intermediate storage location, transportation, warehousing (depots, godowns, yards). [SM 211–212]
- **Installation** needing technical help is part of **cost of production**, not S&D. [SM 212]
- **Selling overheads**: salaries and travel of sales staff, **commission**, sales and **brand promotion** (advertisement, publicity, sponsorship, endorsements), **receivable collection**, **after-sales service**, **warranty**. [SM 212]

- Aggregate of resources consumed; **post-sales costs** (warranty, product liability, after-sales) estimated on a reasonable basis; long-benefit costs **amortised**. [SM 212]
- No imputed cost; **penalties, demurrage, detention** excluded; subsidy reduced; recoveries deducted. [SM 212–213]
- Transport in distribution assigned per **CAS-5**. Presented as a separate head; may be called **marketing overheads**. [SM 213]

CAS-16 Depreciation and Amortisation (Revised 2017)

- **Depreciation**: systematic allocation of the depreciable amount of an asset over its useful life. **Amortisation**: the same for an **intangible** asset (franchise, patent, trademark, copyright). **Land** is not depreciable. [SM 215–216]
- Measured on **depreciable amount and useful life**. Intangibles: residual value zero unless a third-party commitment or an active market; PPE residual value zero if not estimable. Not less than the amount required by law; **regulated industry** → the regulator's figure. [SM 216–217]
- Useful life factors: (a) **wear and tear**, (b) **obsolescence**, (c) **legal or other limits**. An intangible: not beyond its legal rights, and **never more than 10 years** from available for use. [SM 217]
- Starts when **available for use** (fire extinguisher, stand-by generator count as available); stops at held for sale or derecognition. [SM 217]

- Addition integral to an asset → over its **remaining** life; with separate identity → over its own life. [SM 217–218]
- SM WORDS Higher depreciation due to **revaluation** is **not assigned** to the cost object; **impairment loss** is excluded from cost of production. [SM 218]
- Methods: **straight-line, diminishing balance, units of production**; reviewed **at least annually**. Small assets written off in the year of purchase. [SM 218]
- Depreciation of an asset **idle or temporarily retired** = **abnormal cost** for that period. Assets used to build another asset → part of that asset's cost. [SM 219]
- **Disclose:** basis of distribution; credits; revaluation depreciation excluded; depreciation excluded for temporary retirement. [SM 219]

CAS-17 Interest and Financing Charges (Revised 2017) · Dec'23 MCQ, SM MCQ 1

- SM WORDS **Interest and Financing Charges** are interest and other costs incurred by an entity in connection with the **financing arrangements**: interest and commitment charges on borrowings; finance-lease charges; exchange differences on foreign-currency borrowings treated as interest. [SM 181, SM 221]
- Derivative risk-management costs are **outside** its scope. [SM 220]
- **Short-term** borrowing: repayable within **one year** of disbursal; long-term: after one year. **Net current asset** = current assets − current liabilities. [SM 221]

- No imputed cost; subsidy reduced; **penal interest**, fines and penalties excluded (interest for late statutory payments is not penal interest); finance costs of **investments** excluded. [SM 221–222]
- SM WORDS **Presentation:** shown as a **separate line item under the cost of sales**. Prior-period charges taken to reconciliation are shown separately. [SM 222]
- In product costing it is **excluded** from material, utilities, direct expenses, cost of production (CAS-4 para 5.20). SM fill-in 5: interest on working capital is part of **finance** cost. [SM 151, SM 290–292]

- Measured per **AS (2006 Rules) or Ind AS (2015 Rules)**. Identified for (a) **qualifying assets** → included in the asset's cost; (b) other operations. [SM 221]

CAS-18 Research and Development Costs · effective 1 April 2014

- **Research**: original and planned investigation for new scientific or technical knowledge (adapted AS 26). **Development**: applying research to a plan or design for new or substantially improved materials, products, processes **before commercial production**. [SM 224]
- Includes: materials and services consumed; bought-out items; personnel; depreciation of facilities used; overheads **other than general administration**; work done by others; **copyrights or licences**; **computer software**; design of **tools, jigs, moulds, dies**. [SM 224]
- Credits incl. **sale of output** of R&D are deducted. [SM 225]
- R&D not attributable to a product or process is **not product cost**. Development creating an intangible → **amortised** over its useful life; assigned on **benefits received**. [SM 225]
- SM WORDS R&D for the **development and improvement of an existing process or product shall be included in the cost of production**; if it spans periods and yields a distinctly new product, it is accumulated and amortised. [SM 225]
- **Presentation:** improvement R&D under cost of production; other R&D in the **reconciliation statement**. Disclose abnormal costs incl. **abandoned projects**. [SM 225–226]

CAS-19 Joint Costs · effective 1 April 2014

- **Joint costs**: cost of common resources used to produce two or more products or services **simultaneously**. **Joint product**: produced simultaneously by the same process, identifiable at the end, with **sufficient value**. **By-product**: **relatively low value**, produced incidentally. [SM 227]
- **Split-off point** (= separation point): where joint products become separately identifiable. [SM 227–228]
- Costs after split-off measured per product; scrap and waste (net of disposal cost) deducted from the joint product. [SM 228]
- SM WORDS Joint cost assigned on **benefits received** by: (a) **physical units**; (b) **net realisable value at split-off** (net selling price × quantity sold, less post-split-off costs); (c) **technical estimates**. [SM 228]
- **By-product** value: (a) **NRV** or (b) **technical estimates** (when not saleable as it emerges). [SM 228–229]
- Present element-wise cost of each joint product and the value given to by-products; disclose the basis of allocation. [SM 229]

CAS-20 Royalty and Technical Know-how Fee (Revised 2017)

- SM WORDS **Royalty** is any consideration for the use of asset (tangible and/or intangible) to the owner — a % of revenue, per unit produced or of sales value; for mineral resources, patents, trade marks, franchises, copyrights, software. **Technical service fee**: for technical or managerial services. [SM 231]
- Lump-sum / one-time fees **amortised** on estimated output or benefit; no finance or imputed costs. [SM 231]
- Not traceable → assigned on (a) **units produced**, (b) **units sold**, (c) **sales value**. [SM 231–232]
- SM WORDS Royalty for **mining rights** forms part of the **cost of material**. Product or process know-how → **cost of production**; **trademarks or brands** → **cost of sales**. [SM 232]

CAS-21 Quality Control (Revised 2017)

- **Quality**: conformance to requirements or specifications; fitness for the customer's intended use. **Quality control**: procedures designed to ensure products or services meet a defined quality criterion or the client's requirement. **QC cost**: resources consumed in QC procedures. [SM 234]
- Includes the **cost of conformance**: (a) **prevention cost**, (b) **appraisal cost**. [SM 234]
- Traceable QC → the cost object; otherwise on **benefits received**, e.g. the **number of tests** performed for a product. [SM 235]
- Usual exclusions (finance, imputed, abnormal portion, penalties); separate cost head if material. [SM 234–235]

CAS-22 Manufacturing Cost (Revised 2017) · effective 1 April 2015

- For **excisable goods**. **Captive consumption**: goods made by one unit and consumed by another unit of the same
- SM WORDS **Royalty paid on sales shall not form part of manufacturing cost**; lump-sum royalty and know-how amortised on output. [SM 240]

organisation for making other products (s.4(3) Central Excise Act). [SM 236]

- **Manufacturing cost** = materials (incl. process materials), employee cost, utilities, packing, direct expenses, R&M, **pollution control**, QC, R&D, free inputs from the buyer, depreciation and amortisation (incl. free tools, dies, drawings), rework, manufacturing overheads, WIP adjustment, scrap recoveries; **not post-manufacturing** expenses. Same as **cost of production**. [SM 238]
- Admin overheads relating to manufacturing **in**; those of marketing, projects, **corporate office out**. Manufacturing overheads include administration of the factory and **depot**. [SM 236, SM 238]
- Exclusions: abnormal cost, **interest and finance**, fines, demurrage; forex at the transaction date; subsidy from anyone other than the buyer deducted; normal or actual capacity, **whichever is higher**. [SM 240–241]
- **Presentation:** Appendix-1, with actual capacity utilization in absolute terms and **as a % of normal capacity**; elements shown separately. [SM 242]

CAS-23 Overburden Removal Cost (Revised 2023) · Jun'26 MCQ

- **Overburden**: overlying materials generally having **no commercial value**. **Overburden removal cost**: cost to remove the overlying material from the mine site (SM fill-in 2 → **CAS-23**). [SM 246, SM 290–292]
- SM WORDS **Stripping activity**: the activity of overburden removal that **benefits the identified component of an ore** to be mined by the entity (Jun'26 MCQ answer). [SM 246]
- **Stripping ratio** = volume of overburden (m3) ÷ weight of ore (tonnes); "3:1" means three cubic metres of waste per ton of ore. **Standard (average) stripping ratio**: over the project life; reviewed **at least every five years**, at once after radical geological change (e.g. an earthquake). **Current ratio**: overburden removed ÷ mineral produced in the year. [SM 245–246]
- **Advance stripping**: excess overburden removed beyond what is needed for extraction. [SM 247]
- Direct cost: stores, machinery spares, **explosives and detonators**, manpower, equipment, utilities, contractors. [SM 247]
- **Development phase** cost → **capitalised** as a non-current asset when future benefits are probable. **Developed area → charged to ore production at the standard stripping ratio**, whatever the actual ratio; the difference goes to the reconciliation statement (explanation revised by the Council on 5 September 2024). [SM 247]
- Measured by trips of equipment or electronically; computed **mine by mine**. Abnormal: fire, cave-in, flooding. Equipment cost split by **machine hours** between mineral and overburden. [SM 247–248]
- Effective **1st April 2023**. Disclose any variation between the standard and the current ratio. [SM 248]

⚠ The SM's list of standards still shows CAS-23 from 1 April 2017 (the old version); the revised text in the SM is effective 1 April 2023. [SM 127, SM 248]

CAS-24 Treatment of Revenue in Cost Statements (Revised 2017) · effective 1 April 2017

- **Net sales realization**: revenue from operations **net of discounts and indirect taxes**. **Revenue from operations** includes other operating revenue: sale of **by-products**, **manufacturing scrap**, **export incentives**, product-related **subsidies**. [SM 249–251]
- **Other income** (not revenue from operations): profit on sale of PPE and investments; interest on outside investments; insurance claims, penalties or fees received not set against a cost; rent; grants; royalties received; prior-year credits; dividends; forex gains; provisions written back; revaluation credits; recoveries of bad debts written off; prior-period income. [SM 249–250]
- Measured at net sales realization; separately for each unit, each product, **exports / domestic**, manufactured / trading; by-products, rejects, scrap separately. [SM 251]
- By-product NSR (net of further processing) is set against the **joint cost**; scrap, rejects, spoilage against the cost of the related goods; sale of inputs or utilities against their cost. [SM 251]
- SM WORDS **Other income shall not be considered in determining profit or loss as per cost accounts.** Revenue from assets created under **CSR** is also excluded. [SM 251]
- Product-related subsidies → revenue; other operating subsidies → **reduction of the related cost**. [SM 252]
- Present NSR per product split into exports, domestic, manufactured, trading, matched with cost of sales and margin; quantity and price per unit. [SM 253]

R Numbers to learn · Part 3

Rule	Number	Rule	Number
CAS-13 / 14 effective (SM list)	1 Apr 2011 / 1 Apr 2012	intangible useful life, maximum	10 years
CAS-15 effective	1 Apr 2013	short-term borrowing (CAS-17)	within 1 year
CAS-16 to 21 effective (SM list)	1 Apr 2014	current asset / liability test	12 months
CAS-22 effective	1 Apr 2015	standard stripping ratio review	at least every 5 years
CAS-23 (Revised 2023) effective	1 Apr 2023	stripping ratio example	3:1 = 3 m3 per ton
CAS-24 effective	1 Apr 2017	pollution Acts: Water / Air / Environment	1974 / 1981 / 1986

Module 4 · Part 4 · CAS-25 Valuation of Inventory NEW for Dec'26

Dec'26 Supplementary, pp. 2–23: **the only item in the P17 supplementary**. In force from **1st April 2026**; inserted after CAS-24. Never examined, so expect an MCQ (ownership, cost formulae, NRV, non-moving periods) and possibly a Q4 valuation sum. Then: the guidance notes (4.2), GACAP (4.3: one MCQ in Jun'23, but its 16 solved illustrations are the source of most Q4 sums), the SM exercise, and a one-page include/exclude sheet for every CAS sum.

DEC'26 PREDICTION · CAS-25

- **MCQ, very likely**: which items are inventory (ownership test); FIFO / LIFO / weighted average allowed; non-moving = more than 12 / 24 months; cost or NRV whichever lower; change of policy restates two years.
- **Q4 sum, possible** (our prediction file names it first): pick the items that are inventory, build cost (purchase + conversion), compare with NRV, value per item.
- Theory, possible: what is excluded from the cost of inventory; NRV rules for materials and WIP.

MAP OF THIS PACK

1. CAS-25: scope, definitions, ownership test ★★★
2. CAS-25: cost, exclusions, formulae, NRV ★★★
3. CAS-25: presentation, disclosure + a practice sum ★★
4. 4.2 Guidance notes · 4.3 GACAP ★
5. SM illustrations: which exam sum copied which ★★★
6. Material variances (MQP Q4(a) = SM Illustration 16) ★
7. SM exercise with answers · include/exclude sheet

25.1 Scope, definitions, the ownership test

SCOPE AND DEFINITIONS

- Inventory = goods for **future production** (raw materials, parts, packing material, consumables, stores and spares), goods **in process** (WIP), goods **awaiting sale** (finished goods). Valued on **historical cost** basis, for cost and financial reporting. [Supp Dec'26 p.2]
- **Not applied to:** (a) WIP of **construction contracts**; (b) **real property**; (c) **intangible assets**; (d) **shares, debentures, financial instruments** held as stock-in-trade; (e) **live-stock, agricultural and forest products**. [Supp Dec'26 p.3]
- SUPP WORDS **Inventories** are assets (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; (c) materials or supplies to be consumed in production or in rendering services. [Supp Dec'26 p.4]
- **Inventory in transit**: goods owned that have left the point of origin but not reached the destination; inward and outward. [Supp Dec'26 p.4]
- **NRV** = estimated selling price in the ordinary course **less** estimated costs of completion and costs to make the sale. [Supp Dec'26 p.4]
- **Non-moving**: not moved for **more than 12 months** (direct materials, WIP, finished goods, traded goods) or **more than 24 months** (indirect materials, process materials, additives, catalysts). [Supp Dec'26 p.4–5]
- **Slow-moving**: low turnover. **Turnover rate = outward quantity of the preceding 12 months ÷ closing quantity** on the reporting date. [Supp Dec'26 p.6]
- **Normal capacity**: average of **three to five normal years**, abnormal periods excluded (as CAS-2). [Supp Dec'26 p.5]

5.1 OWNERSHIP IS THE TEST

Item	Inventory?
Owned, lying **outside** the premises (e.g. with a job-worker, in transit)	**Yes**
Goods not for sale though in possession (donated items, non-marketable goods)	No
Goods being returned to suppliers; goods received from customers **for repair**	No
Items **on loan or borrowed**: borrowed tools, leased equipment	No
Consignment stock held for a wholesaler or manufacturer	No (for the holder)
Contract manufacturer / loan licensee: goods belonging to the customer	No

[Supp Dec'26 p.6–7]

Classes (5.2): (a) direct materials (raw materials, components, sub-assemblies, spare parts); (b) indirect materials (tools, stores and spares, jigs, dies, moulds); (c) process materials, additives, catalysts; (d) packing material; (e) WIP / semi-finished / intermediate; (f) finished goods incl. by-products and joint products; (g) traded goods; (h) **scrap**. [Supp Dec'26 p.7]

Change in policy (5.3) with material impact: opening and closing inventory **recalculated and restated for the current and previous periods**. Example: a change in 2025-26 → recompute closing inventory of 2024-25 and 2023-24; 2022-23 needs no change. [Supp Dec'26 p.7]

Cost to be adjusted (5.4): incomplete items not in the production line (abandoned production); **expired goods**; **prototypes** (not inventory); goods held for legal reasons (seized, under litigation). [Supp Dec'26 p.8]

25.2 What goes into cost · what stays out · cost formulae · NRV

INCLUSIONS (5.5–5.13)

EXCLUSIONS (5.15) · EXPENSED IN THE PERIOD

1. **Abnormal** wasted materials, labour or other costs;

- SUPP WORDS Cost of inventories shall comprise all **costs of purchase** of goods, cost of purchase of **services** and **conversion cost** incurred in bringing the inventories to their **present location and condition**. [Supp Dec'26 p.8]
- **Conversion cost** = direct employee cost, direct expenses, utilities, depreciation, production overheads, **primary packing**, other costs. **Production-based levies, duties, taxes** are included. [Supp Dec'26 p.8]
- Transfer of finished goods from factory to a **branch or godown** = cost of acquisition at the destination → **included** (transport per CAS-5). Internally developed intangibles used → via amortisation. [Supp Dec'26 p.9]
- **Fixed costs on normal capacity**: under-utilization → fixed cost of the idle part **not** in inventory (expensed); actual level used when it approximates normal; over-utilization → **total** fixed cost included. **Variable** costs on actual production. Semi-variable split. [Supp Dec'26 p.9–10]
- **Purchased items**: per CAS-6 — freight inward, loading and unloading, handling, containers, cartage, **customs clearing agent commission**, non-refundable taxes, **inward quality control**; less trade discounts, rebates, recoveries. [Supp Dec'26 p.10–11]
- **Self-manufactured**: direct material + bought-out services + conversion cost; production overheads include stores, repairs, QC, R&D, royalty, pollution control, production admin; **exclude** other admin, finance cost, selling and distribution. Contract-manufactured or subcontracted items count as self-manufactured. [Supp Dec'26 p.10–11]
- **WIP**: only costs **up to the stage of completion** on the valuation date. [Supp Dec'26 p.13]
- **Scrap:** sold as is → expected price − cost of sale; sold after processing → price − processing − cost of sale; **recycled** → **replacement cost** of the material it replaces − expenses − quality reduction. [Supp Dec'26 p.14]
- **In transit:** factory → branch: proportionate cost at destination included; to a **customer**: distribution cost **not** included; inward to own unit: included. [Supp Dec'26 p.14]

2. **storage** costs, unless needed before a further production stage;
3. **R&D** for new products, prototypes, technologies;
4. admin overheads not bringing inventory to its location and condition;
5. **selling / marketing** overheads;
6. **distribution** overheads;
7. **finance costs** of holding inventory;
8. **contingent liabilities** (e.g. pending law suits).

[Supp Dec'26 p.14–15]

COST FORMULAE (5.16)

SUPP WORDS **FIFO or LIFO or Weighted Average** (periodic or moving). LIFO "may be appropriate" for pricing and product profitability; follow the law for statutory valuation. Specific projects → **specific identification**; **standard cost** if it approximates actual; **retail method** (sales value less gross margin) for many fast-changing retail items. [Supp Dec'26 p.10, p.15–16]

NRV (5.17)

- SUPP WORDS Inventory shall be valued at **cost or net realisable value whichever is lower** ("conservatism"). [Supp Dec'26 p.16]
- Write down **item by item**; similar items of one product line may be grouped. Only for an actual or anticipated **loss**, not a smaller profit. [Supp Dec'26 p.16–17]
- **Materials** are not written down if the finished goods will sell at or above cost; otherwise NRV = **replacement cost**. **WIP** NRV = NRV of finished product − cost to complete. [Supp Dec'26 p.17]
- **Reassess** NRV at each later valuation; reverse the write-down up to cost. A **binding sale agreement** price is used for those items. [Supp Dec'26 p.17]
- Costs to sell: commission, trade discount, brokerage, special advertising, packing for sale, export documentation, outward freight (only when needed to sell). [Supp Dec'26 p.17–18]

EXPENSES AND GAINS (5.18)

- Write-downs for **slow / non-moving**, NRV, damage or obsolescence → **expense** of the period. [Supp Dec'26 p.18]
- Physical **shortage** → valued at the valuation-date rate, expense; **excess** → same rate, gain. Theft, spoilage → not inventory value. All these go to the **profit reconciliation** between cost and financial records. [Supp Dec'26 p.18]
- **Deferred settlement** purchase: the hidden financing element is **interest**, not inventory cost. [Supp Dec'26 p.18–19]
- **Assignment:** trace directly; else cause and effect or benefits received. [Supp Dec'26 p.19]

PRESENTATION AND DISCLOSURE (7–8)

- Total value by class; **Statement showing Valuation of Inventory** (Appendix 1: material cost, bought-out services, conversion cost, total cost, NRV, inventory value, difference and %) with a **Cost Accountant's certificate** (UDIN). [Supp Dec'26 p.19–23]
- **Disclose:** quantity and rates of **major items (5% or more of the class)**; basis of valuation; cost and NRV where NRV used; **physical verification** method and periodicity; shortages and excesses; difference from the valuation given to **banks** for cash credit; production levies included; abnormal cost, demurrage, subsidy, related-party purchases; changes; cost formulae; standard costing confirmation; if **going concern, consistency, accrual** not followed. [Supp Dec'26 p.20–21]

PRACTICE SUM (OUR OWN FIGURES, NOT ICMAI'S) · VALUE THE CLOSING INVENTORY UNDER CAS-25

Item at the year end	Decision and reason	Cost ₹	NRV ₹	Value ₹
Raw material in own store (FIFO cost)	owned → inventory; FG sells above cost, so no write-down of material	4,00,000	3,80,000	4,00,000
Raw material with a job-worker	owned, outside premises → inventory	60,000	—	60,000
Goods held on consignment for X Ltd	not owned → excluded	1,50,000	—	—
Customer's machine received for repair	not owned → excluded	80,000	—	—
Finished goods A (cost incl. ₹10,000 selling overhead)	selling overhead removed; lower of cost and NRV	2,90,000	3,20,000	2,90,000
Finished goods B, slow-moving	NRV below cost → write down; loss to the reconciliation	1,20,000	90,000	90,000
Prototype built for testing	not inventory (5.4)	40,000	—	—
Closing inventory under CAS-25				**8,40,000**

4.2 Guidance notes · 4.3 GACAP · Jun'23 MCQ

GUIDANCE NOTES (4.2)

Explain the CAS more fully for record keeping and audit; sections: introduction, definitions, measurement, assignment, presentation, disclosures, annexures. **So far 13** (SM MCQ 9): on CAS-2 (Revised 2015), CAS-4 (captive consumption, revised), CAS-6, 7, 8, 9, 10, 11, 12, 13; **construction industry incl. real estate**; **treatment of CSR costs**; **compilation engagements** by a Cost Accountant. None on CAS-17 (SM MCQ 11). [SM 254–255]

GACAP (4.3) · WHY AND WHAT

- The MCA's **Expert Group** saw an uncodified set of principles in use and asked for codification; the CRA Rules notified on **30th June, 2014** require cost records per **GACAP and CAS**, variations to be explained. [SM 256]
- **Objectives:** (1) codify GACAP as applied in India; (2) narrow diversities and help develop CAS; (3) a reference where no CAS exists; (4) help stakeholders read cost statements; (5) monitor new concepts. [SM 256–257]
- **Conceptual framework:** (a) focus on drivers of value; (b) cost for a purpose; (c) reality driven; (d) materiality and cost effectiveness; (e) comparability and consistency; (f) transparency and auditability. [SM 258–259]
- **Ancillary product or activity**: incidental, turnover not over **2%** of total turnover or **₹20 crores, whichever is lower**. [SM 259]

GACAP RULES THAT GET ASKED

- SM WORDS Cost of production and distribution of **utilities** is determined on the **normal or actual capacity whichever is higher** (Jun'23 MCQ: answer **higher**). [SM 263]
- Employee: pay for the **lay-off or strike period or suspension** is not cost; ESOP cost is employee cost if it involves cash outlay; incentives accrue over the whole production. [SM 262]
- Overheads: reciprocal or non-reciprocal secondary distribution; **not "what the traffic will bear"**; preference for **cause and effect**; stand-by facilities on expected benefits; fixed overheads on normal or actual, whichever higher; under-absorbed → costing P&L and reconciliation. [SM 265–266]
- Depreciation in cost accounts on a **period of use** basis; cumulative depreciation never over original cost. Interest: in **cost of sales**, not cost of production; no imputed interest on owners' funds. [SM 267–269]
- Disclosure: unit cost; quantities; quantity × rate; basis of valuation; foreign currency; costs excluded; credits; related parties; changes. [SM 270]

⚠ Our analysis file's topic guide for 4.3 says "whichever is lower"; the SM says higher.

SM Illus.	What it is (SM 271–286)	Used in
1	Burnet Ltd: installed, practical, normal, idle, abnormal capacity (CAS-2) [SM 271–272]	**Jun'23 Q3(b) word for word**; postal Q3(a)
2	Reacon Cement: performance analysis from stoppage hours [SM 272–273]	PTP Jun'26 (Module 10)
3	Abnormal cost due to power cut, at base-year prices [SM 273–274]	—
4, 5	Glory Ltd and a 3-shift plant: capacities (CAS-2) [SM 274–276]	practice
6, 7	Cost of production for captive consumption, Rule 30 value (CAS-4) [SM 276–278]	**Jun'24 Q4(b)** (new figures)
8, 9	Landed cost of material; imported material at the importation-date rate (CAS-6) [SM 278–279]	**Dec'23 Q4(a)**, **Dec'25 Q4(a)**
10	Closing stock, average cost, normal and abnormal loss (CAS-6) [SM 279–280]	**Jun'24 Q4(a)**
11	Employee cost (CAS-7) [SM 280–281]	**Dec'23, Dec'24 Q4(b)**; PTP Q4(b)
12	Captive power cost per unit (CAS-8) [SM 281–282]	**Jun'26 Q4(a)**
13	Energy audit: power price and volume variance [SM 282–283]	Modules 10–11
14	Troma Ltd: direct expenses per product (CAS-10) [SM 283–284]	**Jun'25 Q4(a)**, **Jun'26 Q4(b)**, MQP
15	Insurance spare reconditioned (CAS-12) [SM 284–285]	**Dec'25 Q4(b)**
16	Material quality, usage and scrap variance [SM 285–286]	MQP Q4(a)

MODEL ANSWER · MATERIAL QUALITY, USAGE AND SCRAP VARIANCE (SM ILLUSTRATION 16; ICMAI MQP Q4(a) USES THE SAME LAYOUT)

Standard: 1,200 units of material at ₹60 per 1,000 units of output; rejects 25% of input (300); one third reworked at ₹20 (100); the rest scrap at ₹5 (200). Actual: 24,000 units of material at ₹60; output 19,500; 7,000 rejected, 2,500 reworked for ₹51,000, 4,500 scrapped at ₹5. [SM 285]

	Standard (1,000 units)	Actual (19,500 units)
Material	72,000	14,40,000
Rework cost	2,000	51,000
Less: scrap sale	(1,000)	(22,500)
Total · per unit of output	**73,000 · ₹73.00**	**14,68,500 · ₹75.31**

[SM 285–286]

Quality variance = actual cost − actual output × standard cost per unit = 14,68,500 − 19,500 × 73 = 14,68,500 − 14,23,500 = **₹45,000 (A)**. **Usage variance** = standard rate × (actual qty − standard qty) = 60 × (24,000 − 23,400) = **₹36,000 (A)**. **Scrap variance** = actual scrap 22,500 − standard 19,500 = **₹3,000 (F)**. [SM 286]

EX The SM's own exercise for Module 4 (SM 287–292)

1 CAS-17 deals with ★	**Interest & financing charges** (= Dec'23 MCQ)	9 guidance notes issued	**13**
2 CAS-21 deals with	**Quality control**	10 CAS on material cost	**CAS 6**
3 forex of imported material ★	**date of transaction** (= Dec'24 MCQ)	11 no guidance note for	**CAS 17**
4 not cost of transportation ★	**demurrage charge** (≈ Dec'24 MCQ)	12 price 100 + transport 10 + demurrage 10	**110**
5 idle capacity = ★	**installed − actual utilisation**	13 gross 100, TDS 30	**100** (gross)
6 non-executive directors' pay	**administrative overheads**	14 CAS on utilities ★	**8**
7 not employee cost (CAS-7) ★	**compensation for lay-off period** (= Dec'23 MCQ)	15 CAS-10 deals with	**direct expenses**
8 CAS issued so far	**24**	16 direct expenses (CAS-10)	**42 lacs** ⚠

⚠ MCQ 16: 20 (design) + 15 (software) + 7 (travel abroad for training) = 42; finance charges on a design lease are out. Training is an overhead under CAS-7 para 6.5, so 35 is arguable, but the SM key is 42. [SM 178, SM 290–291]

True/False (all False): (1) ESOP cost is **part** of employee cost; (2) executive directors = employee cost, non-executive = **admin overheads**; (3) fines to the Pollution Control Board are **not** pollution control cost; (4) the CRA Amendment Rules 2019 (GSR 752E, 15.10.2019) are effective from **01.04.2018** per the SM key; (5) CAS are issued by **ICMAI** with the MCA's prior approval, not by the MCA. **Fill-ins:** repairs → **CAS-12** · overburden → **CAS-23** · CAS-1 effective **01.04.2015** · **indirect employee cost** · interest on working capital = **finance** cost. **Short essays:** cost centre and its types (Part 1, CAS-1); secondary packing and its treatment (Part 2, CAS-9). [SM 290–292]

R One-page sheet for every CAS sum: include or exclude?

Item in the question	Treatment (standard, para)	Item in the question	Treatment (standard, para)
freight inward, insurance, FOB, import duty	include (CAS-6 5.1.1)	demurrage, detention, penalty	exclude (CAS-6 5.1.8; CAS-4 5.28)
GST / refundable duty (ITC)	deduct (CAS-6 5.1.1)	interest, LC and finance charges	exclude (CAS-6 5.1.2; CAS-4 5.20)
trade discount, rebate	deduct	cash discount	not deducted (financial item)
subsidy, grant, incentive	deduct (CAS-6 5.1.9; CAS-4 5.25)	forex difference after the transaction date	exclude (CAS-6 5.1.7)
normal loss before receipt	absorbed; quantity reduced	abnormal loss / abnormal cost	exclude; value at cost; loss
scrap sale realised	deduct (CAS-4 5.5)	admin OH relating to production	include; other admin out
quality control, R&D on existing product	include in cost of production	selling and distribution overheads	exclude from cost of production
primary packing	cost of production (CAS-9 6.4)	secondary packing	distribution overheads (CAS-9 6.5)
salary, bonus, PF, welfare, exec. director	employee cost (CAS-7)	contractor's employees, strike, VRS closure, arrears, court compensation	not employee cost (CAS-7)
royalty on production, design, software, hire	direct expenses (CAS-10)	royalty on sales	direct expenses in ICMAI's answers; not manufacturing cost (CAS-22)
auxiliary power consumption	deduct from units (CAS-8)	admin share in own-use utility	exclude by CAS-8 5.2.1 (SM Illus. 12 includes it ⚠)
fixed overheads	normal or actual, whichever higher (CAS-4)	GST value of captive supply	110% of cost (Rule 30)
reconditioned insurance spare	book value − market value → R&M (CAS-12)	inventory (CAS-25)	owned only; lower of cost and NRV

Module 5 · Cost Auditing Standards 101–104 P17 · 5.1

SM pp. 296–322, exercise 323–326. **8 marks in 7 papers, all MCQs** (Jun'23 one, Jun'24 three), plus one MCQ in the MQP and two in the PTP. **Learn which standard says what**: that is the whole module for the exam. (Do not confuse these Cost **Auditing** Standards with the Cost **Accounting** Standards of Module 4.)

Paper	MCQ and its answer
Jun'23	The standard holding "the overall objectives of the cost auditor" (reasonable assurance against material misstatement) = **CAS 103**
Jun'24	(v) susceptibility of an assertion to a material misstatement before considering controls = **inherent risk** · (vi) CAS 103 deals with **overall objectives of the independent cost auditor and the conduct of an audit** · (ix) knowledge of the design of internal control is used to **identify the types of possible misstatements**
Dec'26?	MQP: a CAS 103 MCQ · PTP: the standard on **timely documentation** = CAS 102; **who issues** them = the Cost Auditing and Assurance Standards Board, with MCA's approval

DEC'26 PREDICTION · 1 MCQ LIKELY (SLOTS (iv)–(vii), 10–30%)

- Which CAS: plan / audit plan / strategy → **101** · documentation, timely, ten years, audit file → **102** · overall objectives, opinion, scepticism, audit risk → **103** · knowledge of business, internal control, IT environment → **104**.
- Facts: approved by MCA on **10th September, 2015** under **s.148(3)**; effective for audits on or after **September 11, 2015**; **four** standards; issued by the **CAASB** (11 members); **mandatory**.

AUDIT RISK IN ONE LINE

Audit risk = risk of material misstatement (inherent risk + control risk) × detection risk. Inherent and control risk are the **entity's** risks; detection risk is the **auditor's**, the only one he controls. The higher the assessed risk of material misstatement, the **lower** the detection risk he can accept (inverse relation).

5.1 Overview · CAS 101 planning · CAS 102 documentation

- SM WORDS MCA, by letter dated **10th September, 2015**, under **section 148(3)** of the Companies Act, 2013, approved: **CAS-101** Planning an audit of Cost Statements; **CAS-102** Cost Audit Documentation; **CAS-103** Overall objectives of the independent cost auditor and the conduct of an audit in accordance with Cost Auditing Standards; **CAS-104** Knowledge of business, its processes and the business environment. They are based on the IAASB's **ISAs** (ICMAI is a founder member of **IFAC**) with modifications; a cost auditor has the same rights, duties and obligations as a financial auditor. [SM 296]
- **CAS 101 objective**: guide members in **planning** the audit of cost statements so it is efficient and effective, incl. the **overall audit strategy and audit plan**. **Definitions**: audit; audit partner; **audit plan** (nature, timing and extent of risk assessment and further procedures at the assertion level); **audit risk** (inappropriate opinion on materially misstated statements: risk of material misstatement + detection risk); audit team (incl. external experts); auditee; cost audit; cost auditor (a cost accountant under the Cost and Works Accountants Act 1959); firm (incl. LLP); **initial audit** (first audit, or the previous period audited by a different firm); misstatement (error or fraud); **overall audit strategy** (scope, timing, direction); risk assessment. [SM 297–298]
- **Requirements**: before planning, ensure the **appointment is proper** (letter received, legal formalities), ethics satisfied, terms of reference understood; partner and key members plan and discuss; formulate the strategy considering preliminary results, previous audits, knowledge of business, scope, **statutory deadlines and format**, direction, resources; develop the plan; plan supervision and review; update both; **document** them and the reasons
- **CAS 102** purpose: evidence of the basis for the conclusion and that the audit followed the standards and the law; also helps plan, supervise, be accountable, keep matters of continuing significance, quality reviews (**Guidance Manual for Audit Quality** of the QRB) and external inspections. **Audit documentation** = records, **in physical or electronic form**, incl. working papers prepared by and for, or obtained and retained by the cost auditor; **audit file**; **audit working papers**. [SM 302–303]
- **Requirements**: record procedures, evidence, conclusions; enough for **another competent person with no previous connection** (incl. a peer reviewer) to understand compliance, results, evidence and significant judgments; record discussions with client personnel and outsiders; record any **departure** from a standard; record items tested, who performed and reviewed, with dates; prepare documentation **on a timely basis** (= PTP MCQ); document procedures after the report date; assemble it in an **audit file**. [SM 303–304]
- **Contents**: checklists (Rules, Cost Accounting Standards, GACAP), audit programmes, **analysis** ("cost audit relies more on analytical review than on substantive testing"), audit query list, abstracts of contracts, confirmations, management representation, copies of records. Paper or electronic (guard against deletion); **oral explanations cannot substitute**; evidence of conformance (plan, signed appointment letter, minutes); significant matters (e.g. substitute materials, irregular stock heaps; normal capacity judgement); minimum for small entities. [SM 304–306]
- Assemble as the audit goes on; do not discard before the retention period; the documentation is the **property of**

for changes; in an initial audit, acceptance procedures and **communication with the previous auditor**. [SM 299–300]

- Planning is **continuous and iterative**; matters for the strategy: the cost reporting framework and reconciliation with financial reporting, industry regulators, unique industry features (e.g. "product" in newspapers), reliance on financial, other cost and internal auditors, **IT / ERP**, statutory and Board timelines, resources; independence lost by e.g. designing the cost accounting system; small entities: less elaborate. Effective for audits on or after **September 11, 2015**. [SM 300–301]

the cost auditor; retained **at least ten years from the date of the Cost Audit Report**. [SM 306]

5.1 CAS 103 overall objectives · CAS 104 knowledge of business · Jun'23, Jun'24 MCQs

- SM WORDS **CAS 103 overall objectives**: **(2.1) to obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud or error**, and to express an opinion whether they are prepared per the cost reporting framework, the Cost Accounting Standards and **GACAP**, giving a **true and fair view** of the cost of production, cost of sales and margin; **(2.2) to report** as required by law or the standards. If reasonable assurance cannot be obtained: **qualify**, in extreme cases **disclaim**. [SM 307]
- **Requirements**: ethics and **independence**; comply with every relevant standard and understand its whole text; claim compliance only if fully complied; depart only in exceptional cases with alternative procedures; plan and perform with **professional scepticism**; obtain **sufficient appropriate evidence** to reduce audit risk to an acceptably low level; use **professional judgment**; check the cost reporting framework; no compliance procedures unless non-compliance is identified or suspected (but obtain a written representation); modify the opinion if an objective cannot be met. [SM 309–310]
- **Ethics**: independence, integrity, objectivity, competence and due care, confidentiality, professional conduct; maintaining cost records, designing cost systems and **internal audit erode independence**. **Scepticism**: a questioning mind; management representations are **not a substitute** for evidence. **Absolute assurance is impossible**: sample testing, limits of internal control (override, collusion), evidence persuasive rather than conclusive; an audit does not assure future viability. [SM 310–312]
- **Risk and materiality**: the auditor is concerned only with risks that may affect the cost statements and with **material** misstatements, at the **overall cost statement level** (pervasive, e.g. control environment, management override) and the **assertion level** (cost heads, items, disclosures). Inherent risk is higher for complex calculations and estimates; control risk always exists; **detection risk cannot be reduced to zero** and bears an **inverse relationship** to the assessed risk of material misstatement. Management, not the auditor, prepares the cost statements. [SM 313–315]
- **CAS 104 objective**: knowledge of the client's business sufficient to identify the events, transactions and practices that may significantly affect the examination or the report (general knowledge of the economy and industry, particular knowledge of the entity). [SM 316]
- **Requirements**: understand (a) the **nature of the entity** (processes, major inputs, joint and by-products, wastages, outputs, ownership, governance), (b) industry, regulation and reporting frameworks, (c) its **cost accounting policies**, (d) how it measures performance; its **internal control**: control environment (honesty and ethics), risk assessment process (identify, likelihood, significance, action), cost / management information system, control activities, monitoring, and the **adequacy of internal audit** over cost records; the **IT environment**: architecture, access controls, change controls, data integrity and security (SM MCQ 6: CAS **104**); identify and assess the risks of material misstatement (fraud, recent developments, **related parties**, subjectivity, revision); document all this. [SM 317–319]
- **Guidance**: a continuous process; special areas: **abnormal losses, lower yields, higher wastages, higher utilities consumption, related party transactions**; industry factors (competition, cycles, technology, excess capacity, energy, environment); performance pressures may motivate misstatement; evaluate design and implementation of controls beyond discussions; **significant risks** judged before controls; not every business risk is a misstatement risk; IT risks (inaccurate processing, unauthorised access or changes, excess privileges, manual interventions, data loss). [SM 319–322]

SM EXERCISE KEYS (SM 326)

MCQs: 1 planning = **101** · 2 total issued = **4** · 3 guide members in planning = **101** · 4 timely documentation = **102** · 5 develop an audit plan = **101** · 6 IT environment and control = **104** · 7 issued by the **Cost Auditing & Assurance Standard Board** · 8 section **148** · 9 approved by the **Ministry of Corporate Affairs** · 10 forming and expressing an opinion = **103** · 11 approved **10.09.2015** · 12 the Board has **11** members. True / false: issued by the Central Government (F: by ICMAI with its approval) · formulated by the CASB (F: the **CAASB**) · ICMAI a founder member of IFAC (T) · an engaged engineering expert is part of the audit team (T) · working papers prove compliance with Cost Accounting Standards (F: Cost **Auditing** Standards) · advisory (F: **mandatory**). Blanks: CAS 104 issued 10th September, 2015, effective 11th September, 2015 · CAS 102 = cost audit documentation · auditee · company management · section 148(3). [SM 326]

Module 6 · Cost Audit Programme P17 · 6.1–6.3

SM pp. 329–367 (no SM exercise for this module). **36 marks in 7 papers. "Factors in planning a cost audit assignment" was Q3(b) three times** (Dec'23, Dec'25, Jun'26, almost word for word); the other two long questions asked for a **checklist** for one cost element.

Paper	Question	Paper	Question
Jun'23	Q4(a) **audit checklist: repairs and maintenance cost** (8)	Dec'25	Q3(b) **factors to consider in planning a cost audit assignment** (= Dec'23)
Dec'23	Q3(b) **important factors in planning the cost audit assignment**	Jun'26	Q3(b) **appointed as cost auditor: identify the planning factors** (third time)
Dec'24	Q3(b) **checklist to audit production, product-wise**	Dec'26?	Q3(b): planning factors 25% · a checklist 15% (the rest of Q3(b): stages of audit 30%, XBRL 20%)

DEC'26 PREDICTION · Q3(b), 7 MARKS

- A fourth "planning factors" is possible (25%), but Q3(b) also rotates to **stages of audit** (Module 7, in both the MQP and the PTP) and **XBRL** (Module 8).
- Checklists never asked yet: **raw material**, **electricity / DG set**, **steam**, **employee cost**, **stores and spares**, **packing**, **sales value**, **administrative / selling overheads**. They share one pattern (box on the right): learn the pattern, then the 2–3 points unique to each.

THE CHECKLIST PATTERN (FITS ANY COST ELEMENT)

1. **5-year trend**, cost-centre wise (find the **A category** centres = 70% to 75% of the cost).
2. **Product-wise** trend, in ₹ lakhs and **₹ per MT**; higher ₹/MT often = **low capacity utilisation**: tell management.
3. **Quantity balance**: opening + receipts − consumption = closing; input / output ratios.
4. **Meters** installed and **calibrated**; monthly reports as the basis.
5. Pick **major items**: booked to the **right cost centre**; employee, stores, depreciation, insurance only of that centre.
6. Tie the **expense control chart** to the **Trial Balance**; ask for the MIS tables.

6.1–6.2 Planning the cost audit · Dec'23, Dec'25, Jun'26 Q3(b)

- SM WORDS A cost accountant in practice plans the work with **professional care**, recognising that circumstances may cause the cost statements to be **materially misstated**; the audit is programmed to give **reasonable assurance** that the cost information is free of material misstatements. [SM 329]

ADD-ON FOR "YOU HAVE BEEN APPOINTED…" (JUN'26): THE PLANNING STEP (MODULE 7)

Timing and duration of the audit and unit visits; level and number of personnel, supervision and review; the audit partner's days; an **overall audit plan and strategy**; **materiality and sampling levels**; audit procedures (management representation and assertion, tests of controls and details, substantive and analytical procedures); **risk assessment**; discussions with key personnel, the **previous cost auditor**, the statutory and internal auditors; inputs: preliminary activities, previous audits, knowledge of business, scope, **statutory deadlines and format**. [SM 377]

OVERALL CHECKLIST OF THE PROGRAMME (SM 364–366)

1. **Familiarisation with the company**: nature of business (Annual Reports of at least 5 years; objects in the MoA); objectives and strategies; ownership; corporate structure, subsidiaries.
2. **Company records**: MoA, AoA, technical collaboration, inter-company contracts, secretarial registers (material points only).
3. **Organisation**: heads of finance and costing, directors and KMP, delegation of authority, MIS and cost control.
4. **Organisation profile**: an organisation chart.
5. **Policies**: capitalisation and finance, products and by-products, inter-company transactions.
6. **Sales policy**: pricing (home, export), distribution, credit and collection.

MODEL ANSWER · "FACTORS IN PLANNING THE COST AUDIT ASSIGNMENT" (SM 330–331)

Three important factors: **(a) audit personnel**, **(b) documentation of procedures and evidence**, **(c) quality control** over the assignment. [SM 330]

(a) Audit personnel: their **experience and training** for the **industry**; a two-pronged approach: study the **industry** and the **Annual Reports of at least 5 years**. The team needs direction and supervision and must: (i) **physically inspect** the activities and areas; (ii) know the **key personnel** for activities and cost records; (iii) inspect the **cost accounting records**; (iv) study **budgets, plans and strategies**; (v) study the **cost accounting system and its basis per the relevant CAS**; evidence filed in the cost audit file. [SM 330]

(b) Documentation: document everything that supports the opinion; **working papers** = papers prepared by, for, or obtained by the cost auditor; they may hold non-accounting data (production schedules, statistics) for performance analysis. Daily worksheets record every query, how it was discussed and whether satisfied; **standardised papers** (checklists, confirmation forms, standard letters) improve efficiency; the entity's schedules are used only once satisfied they were prepared with care. Files indexed for **quick retrieval**; **confidentiality, safe custody and retention** per legal and professional needs. [SM 330–331]

(c) Quality control (direction, review, monitoring): (a) monitor progress of cost records; (b) check assistants have the **skill and competence** for their tasks; (c) be aware of cost accounting and auditing questions raised, assess them and **modify the plan**; (d) resolve **differences of professional judgement**. [SM 331]

7. **Production planning and control**: process flowcharts, layout, licensed and installed capacities.
8. **Accounting systems**: financial, cost, integrated, stores, ERP; procedures manual.
9. **MIS**: budgets, standard costing.
10. **Internal audit and internal control**: manual and reports.
11. **Cost records**: cost records and statements, the Cost Accounts Manual, **previous cost auditor's reports**.

[SM 364–366]

Information to obtain: one-time (organisation chart, process flow chart, cost centres, machine capacities, products, collaboration and royalty, bill of materials, utilities, pollution control, exports, loans, budgets, costing policy) and for the audit period (accounts and Trial Balance, inventories, cost-centre expenses, material and packing consumption by product, WIP by stage, scrap, utilities generated and used, machine downtime, sales by domestic / export, overhead bases, **GST returns**). [SM 366–367]

6.3 Checklists by cost element · Dec'24 production, Jun'23 repairs and maintenance

MODEL ANSWER · DEC'24 Q3(b) PRODUCTION, PRODUCT-WISE (SM 332–333)

1. **Inventory balancing** for each finished product: **opening stock + production = external sales + internal transfers + closing stock**.
2. Last year's **closing stock = this year's opening stock**.
3. **Capacity utilisation of the previous 5 years**, product-wise.
4. For **abnormal under-utilisation**, seek reasons and management's plan; focus where the product is profitable or has a positive contribution.
5. Where **capacity was added** but production is equal to or less than last year, seek reasons.
6. Ask for the MIS reports: Table 1 (inventory balancing) and Table 2 (capacity utilisation, 5 years).

[SM 332–333]

- **Raw material**: quantity balance (opening + purchases − consumption = closing); **input / output ratios for 3 to 5 years**, the least = **benchmark**; normal evaporation loss charged as consumption; sale of residue reduces the cost of the product it comes from; R&D savings checked; **FIFO or weighted average, applied consistently**; cost-centre totals agree with the Trial Balance; in-house material at its cost centre's cost; imported / local in the same proportion in all products; port tank rent is material cost; **demurrage, detention and penalties are not landed cost**; goods in transit at year end; stock-verification adjustments; receipts valued with freight; over-usage statements; rate trend for 4 years. [SM 333–335]
- **Key raw material inventory**: current stock vs consumption; closing stock as **months' cover** (cost locked up). [SM 336]
- **Electricity**: A category centres; more consumption without more output needs explanation; 5-year trend of ₹/KWH and ₹/MT; **meters installed and calibrated**; monthly electrical report as the basis; several sources → buy the optimum from the **cheaper source**. **DG set**: monthly report (hours run, diesel used, units generated); **units per litre of diesel for 5 years**; allocation in line with output; only DG employees, stores, depreciation, insurance. [SM 336–340]

MODEL ANSWER · JUN'23 Q4(a) REPAIRS AND MAINTENANCE COST (SM 347–349)

1. Obtain **cost-centre-wise R&M for 5 years** (Table 28) from the CMA or finance department or ERP; investigate any substantial increase with the **head of that cost centre** to prevent recurrence.
2. Find the **A category cost centres** (**70% to 75%** of R&M) and focus control and reduction there: a small step there gives a far greater benefit.
3. Obtain **product-wise R&M for 5 years** (Table 29) and discuss increases.
4. Pick a few **major R&M items** and check they are booked to the **correct cost centres**.
5. **R&M per MT** by product (Table 30): a higher figure may be due to **lower capacity utilisation**: highlight it to management.
6. Go through the **expense control chart** of plant-wise expenses tied to the **Trial Balance**.

[SM 347–349]
Add from CAS-12 (Module 4 notes): separate routine maintenance from capitalised repairs; R&M of service cost centres apportioned on benefit; abnormal R&M excluded.

- **Stores and spares** (same pattern): cost-centre and product-wise for 5 years; **A category = 70% to 75 %**; major items to the right centre; ₹/MT; expense control chart tied to the Trial Balance. [SM 345]
- **DM water**: own cost centre; monthly report (filtered water, chemicals, KWH, water generated and allocated); meters; chemicals from the priced stores ledger. **Steam**: boiler report (running hours, steam MT, DM water, KWH, fuel, auxiliary use, **line losses**); ratios for 5 years (cost per MT, steam per unit of fuel, auxiliary and line losses to total, steam and cost per MT of product); insulate pipelines. [SM 341–344]
- **Employee cost**: cost, headcount and cost per employee for 5 years, cost-centre and product-wise; ₹/MT; payroll cost centres updated for **transfers**; justify headcount increases. **Insurance** and **depreciation**: same pattern; a jump may mean **allocation or capitalisation to the wrong plant** (fixed asset register). [SM 349–355]
- **Administrative overheads**: trend for 4 years and ₹/MT; consistent allocation basis; **donations and penalties not charged to products** but shown in the reconciliation; rate contracts for stationery; travel; litigation cost not more than the benefit. **Selling and distribution**: needed for product profitability, control and **price fixation**; trend, ₹/MT, travel reasons with marketing. [SM 357–360]
- **Packing material**: negotiate high-value items; packing cost recovered in invoices of packed sales; quantity balance; FIFO / weighted average consistently; no demurrage; rates and consumption per MT for 5 years. **Sales value**: focus on A and B products; realisation raised to absorb variable cost; more orders and capacity for **high-contribution** products; no stock locking up working capital. [SM 360–362]

Module 7 · Documentation and Audit Process P17 · 7.1–7.3

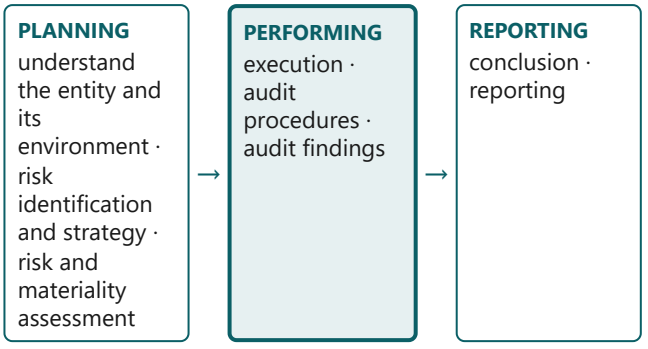
SM pp. 372–378 (no SM exercise). **12 marks in 7 papers** but **both ICMAI practice papers ask "the stages of an audit of cost statements" as Q3(b)**, and their answers are SM 372–373 word for word; it was long only once (Jun'23, 8 marks). **Short module, high return**: learn it whole.

Paper	Question	Paper	Question
Jun'23	Q4(b) **the three stages of audit: analyse them** (8)	Jun'26	MCQ: **market competition trends** is not a working paper the cost auditor obtains (production schedules, quantitative and statistical data are)
Dec'25	MCQ: the stage with detailed testing of controls, consumption, cost accumulation, allocation, apportionment, absorption = **performing**	Dec'26?	**MQP Q3(b) + PTP Q3(b): stages of audit** · MQP MCQ definition of audit documentation · PTP MCQ sequence of stages

DEC'26 PREDICTION

- **Q3(b), 7 marks: stages of audit 30%** (the single most likely Q3(b) topic, ahead of planning factors 25% and XBRL 20%).
- **MCQ (vi)–(vii)**: documentation 30%, process 30%: definitions of audit documentation, audit file, working papers; which stage does what; what working papers include.

THE THREE STAGES (FIGURE 7.1)



SM 372. The SM's own heading (SM 373) calls the last stage "concluding and reporting".

7.1 Documentation and the stages of audit · Jun'23 Q4(b), MQP and PTP Q3(b)

- SM WORDS **Audit documentation** means the material including working papers **prepared by and for, or obtained and retained by** the cost auditor in connection with the performance of the audit (= MQP MCQ). [SM 372]
- **Audit file**: one or more folders or other storage media, **in physical or electronic form**, containing the records that comprise the audit documentation for a specific assignment. [SM 372]
- **Audit working papers**: documents which record all audit evidence obtained during audit, used to support the work done and give assurance that the audit was performed in accordance with the **Cost Audit and Assurance Standards**. (Module 6: they may include production schedules, quantitative and statistical data, hence the Jun'26 MCQ.) [SM 372]

ONE LINE PER STAGE

Plan = understand, find risks, set materiality, choose a strategy. **Perform** = test controls, then substantive tests of consumption, accumulation, allocation, apportionment, absorption and year-end balances. **Report** = weigh the evidence, form the opinion on fair presentation, write the cost audit report.

MODEL ANSWER · "THE THREE STAGES OF AUDIT" (SM 372–373 = THE ICMAI ANSWER)

The stages of an audit of cost statements are **(1) planning, (2) performing, (3) reporting**. Once the acceptance or continuation decision is made, the first stage is **planning**: (i) **understanding of the client**; (ii) factors that may impact the **risk of a material misstatement** (the risk that the cost statements include a significant error or fraud); (iii) a **risk and materiality assessment**; (iv) an **audit strategy**. The **execution (performing)** stage = detailed testing of internal controls and **substantive testing** of cost accounting policies and procedures. The **reporting** stage = evaluating the results in the light of the understanding of the entity and **forming an opinion on the fair presentation** of the cost statements as a whole. [SM 372–373]

Planning, first stage: "a well planned audit is almost half way done"; the audit strategy and the nature and timing of procedures, for **efficiency** (time spent gathering evidence) and **effectiveness** (minimising audit risk); sufficient appropriate evidence at the cost-statement level. [SM 373]

Performing, second stage: detailed testing of internal controls, **material consumptions, cost accumulation, allocation, apportionment, and absorption** (= Dec'25 MCQ); **tests of controls** if relying on the client's controls; substantive tests of procedures for the period and of

consumptions and balances at the period end: the evidence of fair presentation. [SM 373]

Concluding and reporting, final stage: conclusions from the evidence and an **opinion** on fair presentation, expressed in the **cost audit report**, drawing on the understanding of the client, its risks, and the results of testing controls, transactions, cost heads, items of cost and disclosures. [SM 373]

7.2–7.3 The audit process (Figure 7.2) · practical steps I–VI

Activity	Purpose	Documentation
Planning phase		
preliminary engagement activities	accept the engagement?	risk factors, **independence**, engagement letter
plan the audit of the cost statement	overall strategy and plan	**materiality**, team discussion, strategy
risk assessment procedures	assess the risk of material misstatement via the entity and its processes	business and **fraud risk**, design of controls, risk at **statement and assertion level**
Performing phase		
design responses and further procedures	respond to assessed risks	updated strategy, responses, plan
implement the responses	reduce audit risk to an acceptably low level	work done, findings, supervision, **working paper reviews**
Reporting phase		
evaluate the evidence	more work needed? (yes: loop back)	revised risks and materiality, communications, conclusions
prepare the cost auditor's report	form an opinion	significant decisions, **signed audit opinion**

SM 374.

- **Step I, objectives and management outlook**: statutory only, or also cost reduction, operational efficiency, product-mix, profit and loss products, marketing strategy, a review of business strategy? [SM 375]
- **Step II, pre-conditions**: understand the objectives, area and scope, **number of cost auditors**, reporting framework, period, **statutory deadlines**; confirm management accepts its duties: cost records, cost statements per the **cost accounting standards**, consistent policies, access to all records and people, extra information, **management representation**; agree fee and payment; get an **engagement letter**. [SM 375–376]
- **Step III, understanding the business**: nature, size, products, units, ownership and structures; industry; regulatory and reporting frameworks; production process, joint and by-products, outsourcing; subsidiaries; key personnel; purchase, sales, pricing, export policies; inventory and physical verification; **related parties**; indirect taxes; internal control and internal audit; accounting and costing systems; MIS and risk management; IT and data security; the **previous auditor's report**. [SM 376]
- **Step IV, planning**: timing and duration, unit visits; personnel and supervision; the partner's days; overall plan and strategy; **materiality and sampling**; procedures (representation, assertions, tests of controls and details, substantive and analytical); risk assessment; discussions with the previous cost auditor, statutory and internal auditors; inputs; document and share the plan; the **Guidance Manual for Audit Quality**. [SM 377]
- **Step V, execution**: perform the checks; collect evidence and validate its relevance, reliability, accuracy, completeness, sufficiency, source and consistency; **draft observations discussed with KMP**; final report. **Step VI, documentation**: plan and strategy, working papers, evidence, drafts and discussions, the final report, preserved in a bound folder for the prescribed period. [SM 377–378]

Module 8 · Preparation and Filing of Cost Audit Report P17 · 8.1–8.5

SM pp. 381–396 (no SM exercise for this module). **41 marks in 7 papers. Q3(b), 7 marks, was XBRL filing in Jun'24 and Jun'25**; CRA-3 contents came long in Jun'23 and Dec'23; **2–3 MCQs in every paper since Jun'25** (forms, 30 days, costing taxonomy, where XBRL does not apply, the Board).

Paper	Question	Paper	Question
Jun'23	Q5(a) **cost auditor's duty to highlight utilisation of resources** (4) · Q5(b) **when a qualified report is issued** (4)	Jun'25	Q3(b) **steps for filing the cost audit report with the CG** · MCQs: CRA-4 within **30 days**; **costing taxonomy**
Dec'23	Q6(a) **CRA-3 contains more management-audit basics than production data**: comment · MCQ report in **CRA-3**	Dec'25	MCQ: XBRL does **not** apply to internal management reports and confidential communications
Jun'24	Q3(b) **process to file reports in XBRL format**	Jun'26	MCQs: report submitted to the **Board of Directors** (= MQP); CRA-3 = **form of cost audit report**
Dec'24	—	Dec'26?	MQP MCQs: report filed in **CRA-4**; **validation is the pre-requisite** · PTP MCQs: XBRL based on **XML**; Part A = general information

DEC'26 PREDICTION

- **MCQs are near certain** (Q1(a) items (i) and (vi)–(vii): 20–30% each slot): CRA-1 / 2 / 3 / 4 · 30 days · 180 days · Board · costing taxonomy · validation tool · XML · no extensions.
- Q3(b) 7 marks (about 20% for XBRL): the **8 filing steps** again, or **validation + pre-scrutiny**, or **benefits / uses of XBRL**. Also possible as a short note: **qualified vs adverse report**; **critical elements of the report**.

THE FOUR FORMS (MCQ FAVOURITE)

Form	What	Who / when
CRA-1	cost records to be maintained (30 heads)	company
CRA-2	intimation of the cost auditor's appointment	company, to the CG
CRA-3	**form of the cost audit report**	cost auditor, to the **Board**
CRA-4	**filing** of the report in XBRL	company, to the CG, **within 30 days** of receipt

Appointment, CRA-2 and the 180-day report deadline: Module 2 notes.

8.1–8.2 The report in CRA-3 · its critical elements · Jun'23 Q5(a), Dec'23 Q6(a)

- SM WORDS A cost auditor submits his report in **Form CRA-3**, prepared from the cost records maintained per **CRA-1**; format prescribed by the Companies (Cost Records and Audit) Rules, 2014 (amended as on 15th October, 2019). The **company** has the primary responsibility for the **Annexures**, prepared **in consultation with the cost auditor**. [SM 381]
- Any **material deficiency or qualification** is shown **against the relevant paragraph (i) to (vi)** of the report itself, with details. Findings rest on **verified data**, and are included only after the **company has had an opportunity to comment**; deficiencies go to **management first**; satisfied → drop; not satisfied → qualify to that extent. [SM 381]
- ICMAI: **cost audit is an audit of efficiency of minute details of expenditure while the work is in progress, not a post-mortem examination like financial audit** (a "fait accompli"). It verifies cost records, detects errors and frauds, supports pricing, make-or-buy, cost control and reduction. [SM 382]
- **CRA-1** prescribes **30 (thirty)** broad heads (material, employee cost, utilities, direct expenses, repairs, depreciation, overheads, … reconciliation, related party,

OBJECTIVES OF COST AUDIT (WHY THE REPORT ASKS SO MUCH)

1. verify that cost records are **accurate**;
2. certify that **costing principles** were followed;
3. check that predetermined **procedures** were followed;
4. detect **errors and frauds**;
5. check each item of expenditure was **properly incurred**;
6. see how far cost records help **management decisions**;
7. disclose **inefficiencies** in material, labour, machines;
8. help the external auditor by reducing detailed checking;
9. a **moral check** on cost staff.

[SM 383–384]

CRITICAL ELEMENTS THE REPORT MUST STATE (THE JUN'23 "UTILISATION OF RESOURCES" ANSWER)

a. whether **machines and labour remained idle** for shortage of raw materials;
b. whether large **raw-material stocks stayed unutilised**, locking up working capital;
c. whether the **cost records were adequate** for audit;
d. whether management's **broad policy** was followed;

exports, production, sales, cost statements, statistical records, physical verification). [SM 382–383]

MODEL ANSWER · DEC'23 Q6(a) "CRA-3 CONTAINS MORE MANAGEMENT-AUDIT BASICS": AGREE

1. CRA-3 gives **unit-wise, product / service-wise cost statements and schedules**, and deviations must be reported. [SM 383]
2. **Part D** is a measure of **performance orientation**: (a) product and service **profitability** statement, (b) **profit reconciliation**, (c) **value addition and distribution of earnings**, (d) **financial position and ratio analysis**. [SM 383]
3. The auditor must comment on **idle capacity, locked-up working capital, rising cost and its causes, wastage, areas of cost reduction, operating efficiency of each line**: management questions, not production data. [SM 384]
4. Its objectives include disclosing **inefficiencies in the use of material, labour and machines** and helping management decide. [SM 384]

e. focus on **cost of production, comparative profitability and operating efficiency** of each line, not routine statistics;
f. any **rise in cost** over the previous year, its causes and where it originates;
g. any **wastage** in manufacture and how to avoid it;
h. areas where **cost can be reduced**;
i. whether the cost statement shows a **true and fair view** of the cost of production.

[SM 384]

The company uploads the report in **XBRL** in **CRA-4** within **30 days** of receiving it, with explanations on every reservation or qualification. [SM 384]

8.3–8.4 Qualified and adverse reports · Jun'23 Q5(b)

- SM WORDS A **qualified** report is given when the cost statements are **materially misstated** due to misstatement in **one particular cost element, class of transaction or disclosure that does not have pervasive effect**, and when the auditor is **unable to obtain audit evidence** regarding a particular cost element, its allocation and apportionment, class of transaction or disclosure that does not have pervasive effect. Also issued where the records do not comply with **generally accepted cost accounting principles** or with **CRA-1**. [SM 385]

- **Adverse**: the cost statements are **materially misstated and the misstatements have pervasive effect** on cost of production, cost of sales and margins; taken as a whole they do not conform with generally accepted cost accounting principles; the opposite of a clean opinion: the information is **materially incorrect, unreliable and inaccurate**. [SM 386]
- **Memory:** material + *not* pervasive → **qualified** · material + **pervasive** → **adverse** · cannot get evidence on one non-pervasive element → qualified. Before qualifying, the point goes to management first (SM 381).

8.5 Filing in XBRL · Rule 6(6) · Jun'24 and Jun'25 Q3(b)

- SM WORDS **Rule 6(6)** (as amended by G.S.R. 695(E), 14th July, 2016): every company **within a period of thirty days from the date of receipt** of a copy of the cost audit report furnishes the **Central Government** with the report and full information and explanation on every reservation or qualification, in **Form CRA-4** in XBRL, per the Companies (Filing of Documents and Forms in XBRL) Rules, 2015, with the fees of the Registration Offices and Fees Rules, 2014. [SM 387]
- **XBRL** = a globally accepted **open standard** for digital business reporting, run by the non-profit **XBRL International**; used in more than **50** nations. Tags on data points let publishers share data with assurance, let users **validate** it against business rules at source, present it in any language, currency or format, and rely on standard definitions. [SM 387]
- Tags support preparation, validation, publication, exchange, consumption, analysis. **Uses**: internal and external reporting with financial and cost data; reporting to regulators (tax, central banks, governments); loan reports and credit risk; exchange between government departments, institutions and banks. *Dec'25 MCQ: not "internal management reports and confidential internal communications".* [SM 388]

MODEL ANSWER · JUN'24 Q3(b) "PROCESS TO FILE IN XBRL" (SM 389, SM 395)

1. **Map** the company's cost elements to the costing taxonomy.
2. **Populate** the data in the software / filing tool.
3. **Create the instance document**.
4. **Validate** it with the MCA validation tool.
5. **Pre-scrutinise** it.
6. **Convert to a human-readable PDF** and check the data.
7. **Attach** it to the e-form and **file on the MCA portal**.

[SM 389, SM 395]

- **Why cost data in XBRL**: governments and regulators need sector cost data for **policy making** (confidentiality kept); companies can **integrate financial and cost data** and control better. **Costing taxonomy** = a **dictionary of all cost elements** in the report, with their properties and interrelationships (= Jun'25 MCQ). [SM 389]
- **Conversion**: XBRL-enabled vendor software; mapping tools; third-party packages integrated with accounts; web applications that convert Excel. The software is **bought from vendors**; MCA validates and accepts filing but recommends none. [SM 389, SM 395]
- **FAQ facts**: XBRL is based on **XML** (= PTP MCQ); over **600** organisations in XBRL International; taxonomy files are XML and XSD; ICMAI runs XBRL training; **no extensions** to the costing taxonomy; old Form-I and Form-A replaced by **I-XBRL** and **A-XBRL**; separate instance documents for periods before and after 01.04.2014; a PDF view is advisable, not required. [SM 390, SM 393–396]

MODEL ANSWER · JUN'25 Q3(b) "STEPS TO FILE THE COST AUDIT REPORT WITH THE CG"

Open with Rule 6(6): within **thirty days** of receipt, in **CRA-4**, XBRL. Then the eight steps: [SM 387]

1. **Create the XBRL instance document**: tag the report by **mapping** each costing concept to a taxonomy element; the instance document is an **XML file**; **no extensions** to the core taxonomy.
2. **Download the MCA XBRL validation tool** (costing taxonomy) from www.mca.gov.in/XBRL; validation is a **pre-requisite** (= MQP MCQ); select the taxonomy; proxy settings on a LAN.
3. **Load** the instance document (General Information tag shows the company).
4. **Validate**: latest taxonomy version; all **mandatory elements**; MCA **business rules**; XBRL technical specifications; correct the errors listed and validate again.
5. **Pre-scrutiny** with the same tool online: **server-side validations** against the MCA21 database.
6. **Convert to PDF** ("Export to PDF") and verify; a zero-kilobyte PDF means fix the text per the html guidelines.
7. **Attach** the validated, pre-scrutinised document to **Form CRA-4**.
8. **Submit**: pre-scrutinise the form, sign with the **digital signature** of the person authorised by **board resolution**, upload as a normal e-form.

[SM 390–391]

Common errors: net connectivity; PDF not generated or zero kilobytes; wrong date format (10-05-2021 must be 10/05/2021); Yes/No in Boolean fields; 0-100 in percentage fields; currency code "Rs"; mandatory fields or table lines missing; dimensional errors. Element names in single quotes, values in square brackets, explicit members in curly brackets, axes in parentheses; **"cvc" errors** = schema / XML badly formed → contact the software vendor (Xerces validator). [SM 391–392]

Module 9 · Basics of Management Audit P17 · 9.1–9.6

SM pp. 402–428, exercise 429–430. **34 marks in 7 papers. Q6(b), 7 marks, has been management audit in every paper since Jun'24** (objectives → who is qualified → techniques → the report), plus MCQs. The ICMAI PTP answer ("functions of management audit") is SM 407–408 word for word.

Paper	Question	Paper	Question
Dec'23	MCQs: true statement = **no time limit for the report**; the backbone of any organisation = **information**	Jun'25	Q6(b) **who is qualified to conduct a management audit**
Jun'24	Q6(b) **top objectives of having a management audit**	Dec'25	Q6(b) **techniques of management audit**
Dec'24	MCQ: management audit is useful for **all of the above**	Jun'26	Q6(b) **the management audit report + characteristics of a good one**
Jun'23	—	Dec'26?	PTP Q6(b) **functions of management audit** (never asked) · postal MCQ: when the management auditor's work begins

DEC'26 PREDICTION · Q6(b), 7 MARKS · ABOUT 80% MODULE 9

- Slot model: role of CMAs / qualities / techniques / report (9.6) 25% · nature, scope, functions (9.2) 20% · need, objectives, advantages (9.3) 20% · programme and functions (9.4) 10% · reliability of information (9.5) 5%. The rest: energy audit (15%) or CSR (Module 11).
- Write-first: **functions** (PTP, never asked) · **evidence** · **programme (MAP)** · **qualities** · **multidisciplinary team** · **steps / procedure** · **uses**.

MCQ FACTS (SM MCQs 1–7 + T/F)

- Knowledge of financial accounting, production and costing: **all of the above** · information flow **internally and externally** · MBE, MBO, delegation: **all**.
- **Not compulsory, no time limit** for the report · cost audit judges **internal** efficiency · work begins **after the statutory auditor's ends** · useful for targets, assistance, staff relations: **all**.
- Leslie Howard: investigation from the **highest level downwards**. True: conversant with production · False: part of statutory audit.

9.1–9.3 Definitions · objectives · nature, scope, qualified persons · need · Jun'24, Jun'25 Q6(b)

- SM WORDS **Burton**: an impartial evaluation of management performance beyond that implicitly provided by historical results. **Leslie Howard**: an investigation of a business **from the highest level downwards** to ascertain whether sound management prevails throughout. **William P. Leonard**: a comprehensive and constructive examination of an organisation structure, its plans and objectives, means of operation, and use of human and physical facilities. **IIA**: a **future-oriented, independent, and systematic evaluation of the activities of all levels of management** to improve profitability and other objectives. [SM 402]
- It evaluates the **management team's effectiveness**, not individual executives; beyond conventional audit (planning, organising, coordination, control); detects, diagnoses and suggests remedies; often done before **mergers, restructurings, bankruptcies and succession planning**. Boards judge managers on organic sales, EBIT and segment margins, cash flows, EPS. [SM 402–403]
- **Objectives** (SM 403): helps appropriate decision making; gets desired results and reveals defects; helps management discharge duties; finds **process gaps**, strengthens controls; cost-effective implementation of plans. [SM 403]
- **Nature and scope**: organisation structure and reporting; coordination among departments; a **risk management** structure; stakeholder management; project evaluation

MODEL ANSWER · JUN'24 Q6(b) "TOP OBJECTIVES OF HAVING A MANAGEMENT AUDIT" (SM ORDER)

1. Clearly defined **prime objectives** of the organisation.
2. A clear, lean and thin **reporting structure** with clear-cut lines of reporting.
3. **Goal setting** aligned with business objectivity.
4. **Process benchmarking**; challenge existing rules for effectiveness.
5. **Improvement measures** to give impetus to performance in coming periods.
6. Ways to **restructure** and ensure high-quality service.
7. More effective **resource utilisation planning**.
8. **MIS** to reach production and work efficiency goals.
9. Identify **weak points and managerial inefficiencies** in finance, sales and production.

[SM 409–410]

It also answers financial questions: management's role in budgeting; budget deviations; function-based approval before finance accord; compliance with finance policies. [SM 410]

incl. growth budgets; all areas of management decisions. [SM 404]

- **Need**: reports on policies and their implementation improve management efficiency. **Not compulsory under any law; no qualification prescribed.** Advantages: plans and policies with more objectivity; set objectives achieved; input on process gaps; resource strategy and improvement planning. [SM 406]

MODEL ANSWER · JUN'25 Q6(b) "WHO IS QUALIFIED TO CONDUCT A MANAGEMENT AUDIT?"

1. A **Cost Accountant**, by his closer and more intimate association with the **industrial environment** and the whole **supply chain**, is best placed. [SM 404]
2. **Independent practising vs the company's own cost accountant**: the own accountant cannot act with full **independence** but has a **better grasp** of the company; as the audit is **not prescribed by law**, the company decides. [SM 405]
3. Or a **team**: an industrial or production engineer, a social scientist, an economist and a cost accountant: collective wisdom under one roof. [SM 405]
4. Qualities: knowledge of all managerial functions, financial and cost analysis, economics and business laws, the organisation and its objectives, processes and controls, planning and budgets, the production process; practical, achievable solutions. A **cost auditor cannot simultaneously be the internal auditor**. [SM 404, SM 412]

9.4–9.5 Programme and functions · periodicity · reliability of information · PTP Q6(b)

MODEL ANSWER · PTP Q6(b) "FUNCTIONS OF MANAGEMENT AUDIT" (SM 407–408 = ICMAI'S ANSWER)

Management audit is a **difficult and complex task**. Its functions: (1) a **tight rope walk** with clear, identified roles while dealing with top management; (2) it examines the whole scope of work for review, helping management **pin down and inter-relate performance standards and measurements with ownership of responsibilities**; (3) it gives **valuable suggestions** after proper evaluation. Its aim: appraising a function, department or activity to judge how effectively and efficiently it is discharged with reference to (1) the **narrower departmental goals** and (2) the **broader context of the company as a whole**. [SM 407]

Functions it judges (illustrative): marketing incl. selling and distribution; manufacturing incl. planned maintenance and capacity utilisation; procurement incl. new vendors; project management; inventory control; finance (working and project capital); R&D; insurance against insurable perils; personnel (selection, training, motivation, retention). [SM 408]

- **Programme** (SM 407): study the structure; decision making and line of command; discuss objectives and plans with top management; current policies; areas of improvement; recommendations; are controls in place, adequate, effective? The report covers weaknesses with suggestions, stakeholder relationships, methods of production. [SM 407]
- **Periodicity**: annual (simple, like financial and cost audit) ignores that long-term policies need longer; a compromise of **3/5 years** is more reasonable, with yearly follow-up. **Organising an audit**: a full plan; suitable personnel; clear purpose; a **time-budget** per element; cost projections (direct = auditors' pay; indirect = other employees' time). **Time schedule**: affects cost; flexible but not a farce; in a fire-fighting case the deadline is set and cost matters less. [SM 408]
- **From 'Police Man' to 'Policy Man'**; needs **tone at the top**. Criticism: a vague concept; managers hesitate because the auditor pinpoints their shortcomings. An owner learns whether the management style suits the purpose, operations are controlled, relations with employees and shareholders are healthy, reputation is upheld. Focus: existing policies, rational use of resources, tactics and strategies, **overall team performance, not an individual**. [SM 409]
- **Management Audit Programme (specimen)**: name and address; operation (unit or section); dates (planned, revised, actual); auditors; discussed with; reviewed by. List questionnaire items with their **sources** (interviews, board resolutions, policy documents, manuals); tick and initial each item. [SM 410–411]
- **Uses**: management gets **adequate information** for correct decisions and uses it properly; improves the whole communication system; helps design and review the **MIS**; assists **SWOT** analysis. [SM 411]
- *Dec'23 MCQ: "the backbone of any organisation is **information**" (9.5, reliability of information: not a sentence of the SM).*

9.6 Role of CMAs · steps · techniques · evidence · programme · Dec'25 Q6(b)

- **Role of CMAs**: no statutory obligation; a cost accountant may do internal audit under the Companies Act, 2013 and management audit; specific qualities: grasp business problems; the organisation and its processes; rules and legal aspects, delegation, **MBO, MBE**, budgets, internal control devices; general laws (company, tax, FEMA); engineering, statistics, costing, industrial psychology, managerial economics; result orientation, tact, perseverance. Aspects: plan and policy data; **validation of prior decisions**; authority structure; measuring performance; tax planning and budgeting; **two-way communication**, internal and external. [SM 412–413]
- **Data reliability checklist** (selection): source and basis of data; essential information only; no stale data; full detail where cost matters; look for conflicts; validate data; channels and responsibility; avoid "Garbage In, Garbage Out" by observation and test checks; useless reports and forms; compliance; methods for improvement; protective methods; responsibilities discharged; access control; use of every record; bottlenecks, waste, poor coordination, low morale. [SM 413–414]
- **Steps** (Annexure II): (1) objective and scope, select an area; (2) collect documents and data, discuss gaps, report; (3) do actual results meet standards or targets? if not, why (target too hard? failure costing the organisation?); (4) what is done for planning, operations (up-to-date technology), measurement and control; (5) detailed investigation and evidence; (6) report findings with recommendations. [SM 419]
- **Procedure**: preliminary survey; meet the responsibility owner ("pain points"); collect data; analyse; study the **basic charter** (authorised purposes, limits); review management control (policies, procedures, weaknesses); discuss gaps with the process owner; report. **Ways to find problem areas**: (i) **survey** of control weaknesses (e.g. purchasing: quantity and quality, best prices, checking receipts); (ii) **management reports / MIS**; (iii) **internal audit reports** (especially findings with no action); (iv) **physical inspection** (excess stock, idle equipment, rejections, rework); (v) **test of transactions** from initiation to disposal; (vi) **discussions** with officials (works only if the auditor is not feared). [SM 419–421]

MODEL ANSWER · DEC'25 Q6(b) "TECHNIQUES OF MANAGEMENT AUDIT"

Techniques depend on the area of review (financial reviews: break-even, make or buy, cost-benefit, marginal and standard costing). [SM 421–422]

1. **Accounting or economic**: break-even analysis; budgetary control incl. flexible budgets; cost management for allocating assets over projects; **DCF and NPV**; cost-benefit analysis; standard and marginal costing; **activity-based costing**; quality analysis of transactions.
2. **Scientific** (linear programming, transportation, assignment): **computer models** (material mix, product mix, make or buy); **network analysis** (shortest project time); **mathematical programming** by heuristic (trial and error) methods, linear or quadratic.
3. **Statistical**: **activity sampling**; **Monte Carlo simulation**; exponential smoothing; **inter-firm comparison**.
4. **Personnel**: attitude survey; **ergonomics** (man-machine relationship); training methods; profitability and productivity measurement.
5. **General**: statistical theory of management (analyse the problem, MBO, ways to tackle it, key factors, evaluate alternatives for economy, efficiency and fit, specify action); **brain storming**; transfer pricing; MBO; MBE; corporate planning; information theory.

[SM 422–423]

- **Evidence**: **no fixed items of evidence**; the auditor relies on his **experience and acumen**; sources: discussions, surveys, reports (internal audit, inspection, investigation), physical inspection, test of transactions, departmental files, monthly reviews, minutes and above all **personal observation**; sampling or full detail; he does not rely on a voucher unless the samples demand; **no area of restriction**. [SM 423]
- **An efficient MAP**: review objectives and plans; policies and practices; critical review of the structure; systems and procedures; evaluation of operations; use of physical resources; management control; **MIS** monitoring; statutory obligations; above all, efficiency of **manpower handling**; deal with weak and risk areas in more detail. [SM 424]

9.6 The management auditor, the team, checklist and the report · Jun'26 Q6(b)

- **The management auditor**: special care, technical competence, **independent thinking and an unbiased view** (no financial or sentimental influence), supported by a good team. **Qualification**: broad business experience in an allied profession (accountancy, statistics, engineering, marketing, administration); a team from **different streams** (cross-fertilisation of ideas). [SM 424]
- **Essential qualities**: (i) grasp business problems; (ii) nature and objects of the organisation; (iii) assist its progress; (iv) delegation and control, cash, production, master budgets; (v) internal control devices (flow chart, flow of work, work schedules, computer); (vi) engineering, statistics, cost and management accounting, production planning; (vii) company, tax and economic laws; (viii) report writing for all levels; (ix) **tactfulness, perseverance, pleasing and dynamic personality**. [SM 424–425]
- **Team**: **multi-disciplinary** for a multidimensional approach: seniors with exposure to production, materials, maintenance, personnel, marketing, finance, industrial engineering, quality control. **Checklist areas**: planning, organising, staffing, coordinating, communicating, directing, motivating, controlling, innovating; look for directorial, management, organisational, financial, systems, procedural, functional, operational, marketing, IR, social-responsibility weaknesses and **security lapses**. [SM 425–426]
- **Annexure I checklist** (specimen) heads: administration (manual, committee meetings, backups off-site), finance (budget approval, cash flow review, multiple signatures), insurance (all assets, loss of profit, D&O, renewals, claims), policy (harassment, drugs, child protection), planning (strategic, risk, operational, marketing, evacuation plans), personnel (HR policy, code of conduct, complaints), contracts, hazards (HAZOP, safety inspections), events, legislation ("beyond compliance", duty of care). [SM 415–418]

MODEL ANSWER · JUN'26 Q6(b) THE MANAGEMENT AUDIT REPORT + A GOOD ONE

MAR reflects the quality of the review; a good MAR **motivates management** and gets results. **Characteristics**: (i) **pertinence**, (ii) **comprehensiveness**, (iii) **brevity**, (iv) **timeliness**, (v) **motivating**, (vi) **appropriate**, (vii) **data based** to support the outcome. [SM 426]

- Often "**exception reporting**": deviations, unauthorised activities, deterioration, value destruction; benchmarks and industry norms as scope for improvement; frauds, reputational risk, control lapses; corrective measures. The top executive wants four things: **facts, the person responsible, deviations from standards, and the effect** on the financial or physical status. [SM 426]
- Discuss with the people concerned **before reporting**; every point should have their acceptance; solutions phrased as if from the operational people gain acceptance; logical and readable. [SM 426]
- **Writing**: the reader's understanding comes first; lean, clear, simply worded, not a skeleton; tables, charts, graphs only with a purpose; avoid ambiguity and long sentences; plan after the audit is complete; arrangement; meaningful data; headings; recommendations. **Standardised format** helps the writer, the reader, and offsets "this is directed against me". [SM 426–427]
- **Format**: covering letter; (a) title (organisation, period, dates, auditor); (b) table of contents; (c) **summary of conclusions**; (d) body with details of each finding; (e) appendices. [SM 427–428]
- **Special reports**: banks and creditors (explanatory notes, accuracy, security, clear and positive statements); shareholders (useful to experts and laymen; investor relations; the prospectus report); employees (dispel misconceptions, strikes, low morale; unbiased); small business (simple, subjective, few data). The best report **motivates the reader to act** as desired. [SM 428]

Module 10 · Management Reporting Issues and Analysis P17 · topics

10.1–10.11

SM pp. 433–490. **89 marks in 7 papers.** Since Jun'24 the **Q1(b) 10-mark case (5 MCQs × 2)** is always a Module 10 computation, and Q7(b) is often a Module 10 theory question. The theory is short; the marks are in the **formulas**.

Paper	What was asked	Marks
Jun'23 · Dec'23	MCQ contribution · MCQ labour productivity KPI · Q7(a) **net margin, ROA, ROE, turnover ratios** (= MQP Q1(b) data)	2 · 2 + 7
Jun'24	Q1(b) case: **cash operating cycle, current, quick, sales to working capital** (10.8) · Q7(b) **productive vs allocative efficiency**	10 + 7
Dec'24	Q1(b) case: COGS from stock turnover, sales, PAT, PBT (10.7) · Q4(a) **cement plant capacity utilisation: comment and suggest** (= SM GACAP Illustration 2; PTP Q4(a))	10 + 7
Jun'25	Q1(b) case: **divisional sales and profit** (10.11; = PTP Q1(b)) · Q7(b) **capacity utilisation analysis as a management-audit tool**	10 + 7
Dec'25	Q1(b) case: **fixed / variable factory overhead per unit, cost and profit per unit** (10.6)	10
Jun'26	Q1(b) case: **cost at 60% capacity, export order cost, profit and minimum price** (10.3) · Q7(b) **performance analysis + metrics** (= MQP Q7(b) word for word)	10 + 7

HOW IT IS EXAMINED · DEC'26 PREDICTION

- **Q1(b), 10 marks, certain**: one numeric case. Not yet used: **ratios** (ROA, ROE, margins: the MQP's case) and **working capital** again; also contribution / break-even and capacity pricing. Learn every formula on the last page.
- **Q7(b), 7 marks, likely**: **manpower planning approaches** (PTP; never asked), capacity utilisation, productive vs allocative efficiency, performance analysis steps, management accounting tools.
- A capacity case like Dec'24 Q4(a): compare rated capacity achieved, utilisation, stoppage hours; give reasons and suggestions.

MAP

1. 10.1 Reports: types ★
2. 10.2 + 10.10 Performance analysis ★★
3. 10.3 Capacity utilisation ★★★
4. 10.4 Productivity, productive vs allocative ★★
5. 10.5 Energy efficiency ★
6. 10.6–10.7 Contribution, profitability ★★
7. 10.8 Working capital and liquidity ★★★
8. 10.9 Manpower analysis ★★
9. 10.11 Management accounting tools ★
10. Q1(b) cases worked · formula sheet

10.1 Management reports

- SM WORDS Reporting is the communication of statements with related information between two parties; providing information to the management is **management reporting**; a report is a statement containing facts. The **purpose and level** of the user decide the **frequency, format and size** of a report (CFO vs National Sales Head example). [SM 433]
- Management audit reports: help take the right decision at the right time; build a control culture; analytical, from the company's database; suggest ERP reports (e.g. truck-wise **TAT**); **crisp** for top management, elaborate and action-oriented for middle and junior levels; special assignments. [SM 433–434]
- **By purpose:** (a) **financial** (cash flow, borrowing cost, performance vs budget); (b) **information** reports: **trend, analytical, activity** (SM MCQ 1: all of the above), segment reports; (c) **control** reports for responsibility centres. [SM 434]
- **By nature: enterprise** reports (for external users) · **investigative** reports (for a particular problem). **Functional:** individual activity report · joint activity report (e.g. central procurement with projects). [SM 434–435]
- Good reports: **accurate**, **purposive**, the right **detail**; a **balanced scorecard** turns strategy into quantifiable goals. [SM 474]

10.2 Performance analysis (+ 10.10) · Jun'26 Q7(b) = MQP Q7(b)

- SM WORDS A performance analysis is an **evaluation of how a business or individual has performed within the limited timeframe against set parameters**; variations from projected metrics are studied to pre-empt future failure. [SM 436]
- **What it includes:** parameters to measure against; past parameters and yardstick; no change in them;
- **Business metrics:** income by product line, region, type; **return on sales and on investment**; **profit and sales per employee**; ratios of assets, liabilities and net worth; goals for **three, five and 10 years**; market share; regular review of costs. **Individual:** sales metrics, projects completed by a deadline, contribution to projects. [SM 469–470]

measurement of actual delivery; assumptions (micro, macro); base-level adjustments; monitoring and review; **equal periods** for evaluation; **root cause** analysis of deviations; **feedback** to employees. [SM 436]
- **Who benefits:** employees grow; clear expectations; a better process means better results. [SM 469]

- **Steps for a department or organisation:** (1) **variance analysis** (projected vs actual); (2) **research variances** (root cause); (3) **analyse metrics** (non-financial); (4) **review competitor performance** (SWOT); (5) **decide on changes**. [SM 470]

10.3 Capacity utilisation analysis · Jun'25 Q7(b), Dec'24 Q4(a), Jun'26 Q1(b)

- SM WORDS Capacity utilization is the relationship between the **output produced and the potential output** with the given resources. **Capacity utilization = actual output ÷ maximum output × 100**; e.g. 20,000 of 40,000 = **50%**. Low utilisation = "excess", "surplus" capacity or under-utilisation. [SM 437]
- A **Key Performance Area of operational efficiency**: how well plant, building, land, materials, manpower and utilities are used. Higher utilisation → better use of resources and **lower fixed cost per unit**, better profitability. [SM 437]
- Indian cement: industry capacity above demand; some players run above 100%, some below 70%. [SM 437]

- **Low utilisation → reasons and remedies:** machine breakdown → better maintenance; losing market share → new or improved products through R&D; raw material shortage → new vendors or own plant after cost-benefit analysis; power shortage → wind mills or solar. [SM 437–438]
- **Economic significance:** capacity is built for projected demand; utilisation shows operating efficiency and **cost structure**; higher output → lower average cost → competitive edge; low utilisation = **opportunity loss** as fixed cost is not recovered. [SM 438]
- **Dec'24 Q4(a) / PTP Q4(a) method** (SM GACAP Illustration 2): rated capacity achieved = hourly output ÷ rated (72/80 = 90% → 64/80 = 80%); utilisation fell 82.48% → 62.21%; breakdown hours up 114.48%; planned maintenance down; no-order hours up; total stoppage 4,230 → 4,948 hours. **Suggest:** proper maintenance, secure orders, more wagons, cost-benefit of **captive power**. [SM 272–273]

10.4 Productivity and efficiency · Jun'24 Q7(b)

- **Productive efficiency** (production efficiency): the largest possible output from the available resources. **Production possibility frontier (PPF)**: a curve of the output limits of two products competing for the same finite resources; more of one means less of the other. [SM 439]
- SM WORDS **Productive efficiency** represents the **maximum output of a product given scarce resources**; each extra unit has an opportunity cost; it focuses on **monetary costs and resources**. **Allocative efficiency** measures the **distribution of goods and services**: a market equilibrium where **marginal cost of production = marginal benefit to the customer**; both producer and consumer benefit. Both are limited by externalities. [SM 439–440]

- Productivity = **output per unit of input**: less input per unit of output; more output with the same input. [SM 440]
- **Auditor's levers:** raw materials (superior material if lower usage offsets price; new vendors; approved vendors; avoid emergency purchase; maintain plant); electricity (energy-efficient replacements after cost-benefit; **variable frequency drives**; plant modification; run at optimum capacity; shop-floor suggestions); steam (cut kettle hours and cycle time; insulate to cut transmission losses). [SM 440]

10.5 Utilities and energy efficiency (also the MQP / postal "energy audit" question)

- **Energy efficiency** = using **lesser energy to provide the same product or service**; with renewables, one of the **twin pillars** of sustainable energy policy. IEA: efficiency could cut world energy needs by **30%** by 2050. [SM 441]
- **Auditor looks at:** energy per unit of fuel; trend of energy cost as % of product cost; recycling; better capacity utilisation; replacing plant after cost-benefit and payback; VFDs; pump modification; efficient motors; redesigned piping; wind mills or solar. [SM 441–442]

- Examples: thin-slab and direct casting in steel; **CHP / cogeneration**; LEDs save over **75%**; recycled aluminium saves **95** percent of energy; recycled paper uses **60** percent of the energy. [SM 442–444]
- **Barriers:** fear of high initial investment; unclear benefits; little concern for environmental impact; "old is gold". [SM 444]

10.6–10.7 Contribution and profitability analysis · Dec'25 Q1(b), Jun'23 MCQ

- **Contribution analysis**: the effect of variable costs on net income; contribution margin = contribution ÷ sales, per

- **Profitability analysis**: part of ERP; systematically analyses profits from each revenue stream; finds the most and least

product or line; a product with a low margin that cannot be improved may be dropped; shows how each unit recovers fixed cost. [SM 445]

- **Contribution per unit = (total revenue − variable costs) ÷ units sold**: shirts (4,00,000 − 1,50,000 − 1,00,000) ÷ 15,000 = **₹10.00**. **Break-even = fixed cost ÷ contribution per unit. Margin of safety** = (target − break-even) ÷ target. P/V chart for non-technical managers. [SM 445–446]
- Limits: assumes constant selling price and linear costs. [SM 446]

profitable products; methods: **profitability ratios** (operating margin, **ROA, ROE**, EBIT), **customer-cluster** profitability, qualitative analytics. [SM 447]

- **Product rationalisation: sales-to-stock ratio = net sales ÷ average inventory**; **gross margin = gross profit ÷ net sales**. Auditor's table: sales ↑, raw material and utilities cost ↓, contribution ↑, fixed cost → optimum capacity, profitability ↑. [SM 448]

10.8 Working capital and liquidity · Jun'24 Q1(b) = the SM's Topple Co example with new figures

- Working capital = net current assets for day-to-day operations; central because current assets are a large share of assets, **wealth follows cash** not profit, and poor control is a major cause of collapse. Objectives: **liquidity** vs return (ROCE). Extremes: **over-trading** (too little working capital, under-capitalisation) and **over-capitalisation** (too much). [SM 449]
- **Current ratio** = CA ÷ CL (below 1 may signal trouble; traditional manufacturers 2 or more; big retailers below 1). **Quick ratio** = (CA − inventory) ÷ CL. [SM 449–450]

- **Inventory days** = average inventory ÷ cost of sales × 365 · **receivables days** = receivables ÷ sales × 365 · **payables days** = payables ÷ credit purchases × 365 · **sales to working capital** = sales ÷ (inventory + receivables − payables). [SM 450–451]
- SM WORDS **Cash operating cycle = inventory days + receivables days − payables days** (raw material, WIP and finished goods days in manufacturing). Industry average: 53 + 23 − 47 = 29 days. [SM 451, SM 453]
- Also: raw material inventory in days of consumption; finished goods in days of production or sales. [SM 451]

10.9 Manpower analysis · PTP Q7(b) "approaches to manpower planning" (never asked yet)

- Depth depends on the share of manpower cost in total cost. **Ratios to watch:** (1) training expenses per employee; (2) production per employee or hour (training, plant condition, skills); (3) resignations; (4) new recruitments; (5) labour productivity in numbers, man hours or wages. [SM 454]
- **Dimensions of manpower estimation:** (a) employees available, types, wages; (b) job description per position; (c) age, qualification, experience; (d) **short, medium, long-term** needs. Basis: **annual budget and long-term corporate plan**; techniques: managerial judgement, **ratio-trend**, **Delphi**. [SM 455]
- Objectives (seven): adequate quantity and quality; lower recruiting and replacement costs; lower attrition costs; morale; control expansion or reduction; monitor staffing and retention; focus training. [SM 455]

APPROACHES FOR DEVELOPING MANPOWER PLANNING (THE PTP ANSWER)

1. **Planning for the status quo**: replace those promoted or leaving; **succession planning**.
2. **Thumb rule**: e.g. one supervisor per 12 workmen (1:12).
3. **Markov analysis**: predicts manpower per category and transitions (resignation, dismissal, retirement, death).
4. **Unit forecasting**: supervisors' unit-wise estimates added up ("bottom-up").
5. **Ratio trend analysis**: six people for the work → twelve for twice the work; direct to indirect ratio.
6. **Delphi method**: independent expert judgements by questionnaire.
7. **Computer simulation** of organisational processes and HR movement.
8. **Time and motion study** by an industrial engineer.
9. **MOST** (Maynard Operation Sequence Technique, H.B. Maynard, 1970s): activity-based work measurement; used in automobiles.

[SM 466–467]

Advantages: anticipates shortages and surpluses; right recruitment sources; training needs; performance appraisal; **controls labour cost**; career development; tackles low productivity, absenteeism, conflict. **Peter Principle**: every post tends to be filled by someone incompetent for it. [SM 466–468]

10.11 Management accounting tools

- **Typical tools: break-even** (total cost = total revenue) · **capital budgeting** · **constraint analysis** (bottlenecks) ·

- **Fifteen explained:** financial planning · financial statement analysis · cost accounting · fund flow · cash flow · standard

inventory analysis · **margin analysis** (by customer, region, product, branch) · **transaction analysis** · **trend analysis**. [SM 471]

- **Five groups:** (1) financial accounting: ratios, comparative statements, fund and cash flow, ROCE; (2) cost accounting: marginal and differential costing, standard costing, variances; (3) mathematics: OR, linear programming, network, queuing, games, simulation; (4) future information: budgets, budgetary control, forecasting, project appraisal; (5) misc.: reporting, integrated audit, financial planning, revaluation, decision accounting, MIS. [SM 471–472]

costing · **marginal costing** (pricing, sales mix, scarce resources, make or buy, bulk and foreign orders) · budgetary control · revaluation accounting · decision-making accounting · MIS · statistical techniques · management reporting · historical cost accounting · ratio analysis. [SM 472–474]

- Ratio analysis: compare logically related values (bad debts to turnover, not to fixed assets). [SM 474]

Q1(b) The 10-mark case: three past cases worked

JUN'26 Q1(b) · 60% CAPACITY, TURNOVER ₹90 LAKH, EXPORT ORDER TAKES 40% (PRICING AT SPARE CAPACITY)

Working (₹ lakh)	Domestic (60%)	Export (40%)
Prime cost (60% of sales / given)	54.00	14.00
Factory overhead (17.00 at 60%; extra = 24.50 − 17.00)	17.00	7.50
Admin and selling (fixed: no extra) · shipping	10.00	2.50
(xi) / (xiii) Total cost of sales	**81.00 (A)**	**24.00 (B)**
(xii) Profit 9 ÷ 90 = profit % on sales	10% (A)	
(xv) Price at the same 10% on sales = 24.00 ÷ 0.90 · (xiv) profit		26.67 (C) · 2.67 (B)

DEC'25 Q1(b) · OVERHEAD PER UNIT

Fixed OH rate = 75,000 ÷ 25,000 hours = ₹3 per hour; 3 hours per unit.
(xi) fixed OH per unit = 3 × 3 = **₹9.00 (A)**
(xii) variable = (11.50 − 3) × 3 = **₹25.50 (C)**
(xiii) total = 11.50 × 3 = **₹34.50 (D)**
(xiv) total cost = 75 + 55 + 34.50 + 8 = **₹172.50 (B)**
(xv) profit = 225 − 172.50 = **₹52.50 (C)**

JUN'24 Q1(b) · T LTD (TOPPLE CO METHOD)

Cost of sales = 40 lakh × 70% = 28 lakh.
Inventory days 4.5 ÷ 28 × 365 = 58.7; receivables 3.2 ÷ 40 × 365 = 29.2; payables 2.5 ÷ 32 × 365 = 28.5 → (i) cycle **59 days (B)**
(ii) CR = 7.7 ÷ (2.5 + 4.5 overdraft) = **1.10 (A)**
(iii) QR = 3.2 ÷ 7.0 = **0.46 (B)**
(iv) sales ÷ (4.5 + 3.2 − 2.5) = **7.69 (C)**
(v) **(A)**: cycle longer than the industry's, liquidity risk (the industry cycle is 53 + 23 − 47 = 29 days).

Dec'24 Q1(b) built sales and profit backwards from **stock turnover** (COGS = turnover × average stock; sales = COGS ÷ (1 − GP%)); **Jun'25 Q1(b) = PTP Q1(b)**: divisional sales and profit with transfer prices. **The MQP's case** (not yet in an exam) is Dec'23 Q7(a) data: net profit margin, ROA, ROE, asset turnover.

Formula sheet	=	Formula sheet	=
capacity utilisation	actual ÷ maximum output × 100	current ratio	CA ÷ CL
contribution per unit	(revenue − variable cost) ÷ units	quick ratio	(CA − inventory) ÷ CL
break-even units	fixed cost ÷ contribution per unit	inventory days	avg inventory ÷ cost of sales × 365
margin of safety	(sales − BEP) ÷ sales	receivables days	avg receivables ÷ sales × 365
gross margin	gross profit ÷ net sales	payables days	avg payables ÷ credit purchases × 365
sales-to-stock	net sales ÷ average inventory	cash operating cycle	inventory + receivables − payables days
ROA · ROE	net profit ÷ assets · ÷ equity	sales to working capital	sales ÷ (inventory + receivables − payables)

SM exercise case 1 (per unit: sale 1,00,000; RM 50,000, utilities 15,000, packing 5,000 = variable; employee 5,000, stores 4,000, repairs 3,000, depreciation 5,000, insurance 1,000, overheads 2,000 = fixed): variable **70,000**, fixed **20,000**, contribution **30,000**, profit **10,000**, RM % of total cost **55.56**. **Case 2:** variable = raw material; ageing of plant and OEM spares → consumable stores; fixed asset register → depreciation; discretionary → overheads. [SM 487–489]

Module 11 · Management Audit in Different Functions P17 · 11.1–11.11

SM pp. 495–533, exercise 534–540. **41 marks in 7 papers. Every December paper has had a Module 11 Q7(b)** (Dec'23 personnel development, Dec'24 corporate development, Dec'25 environmental audit), CSR came long twice, and **energy audit sits in the MQP and the postal paper but has never been asked**.

Paper	Question	Paper	Question
Jun'23	Q8(a) **benefits of CSR + how the internal auditor contributes** (9) · MCQ **360° feedback**	Jun'25	—
Dec'23	Q7(b) **evaluating personnel development** · MCQ consumer service audit examines management's responsibility to consumers	Dec'25	Q7(b) **benefits of environmental auditing**
Jun'24	—	Jun'26	—
Dec'24	Q7(b) **corporate development audit: four dimensions + scope** · Q6(b) **CSR + internal auditors in a CSR audit**	Dec'26?	MQP Q6(b) **energy audit** · postal Q7(a) **energy audit + functions of the energy auditor** · postal MCQ consumer service audit

DEC'26 PREDICTION

- **Energy audit** (11.7): about 30% in all (Q7(b) 15% + Q6(b) 15%). Learn the definition (EC Act 2001), the five functions of the energy auditor, preliminary vs detailed audit, specific energy consumption.
- Q7(b) is shared with Module 10 (about half each). Module 11 candidates: personnel development (10%), productivity audit (10%), corporate development, consumer services, environmental (5% each). CSR audit as Q6(b): 5%.
- MCQ facts: 360° feedback · consumer service audit = part of **social audit** · CSR thresholds 500 / 1000 / 5 crore · 2% · **30 days** to the Unspent CSR Account · assurance = **three parties**.

MAP OF THE MODULE

Topic	Exam
11.1 corporate objectives and culture · 11.2 corporate services audit	essays only
11.3 corporate development audit	Dec'24
11.4 personnel development · 11.5 consumer services	Dec'23 (+ MCQs)
11.6 environmental audit	Dec'25
11.7 energy and utilities	**MQP, postal**
11.8 productivity · 11.9 propriety · 11.11 social cost-benefit	never
11.10 CSR audit	Jun'23, Dec'24

11.1–11.2 Corporate objectives and culture · corporate services audit

- A **business objective** is a **measurable step** with a time frame and resources; a **goal** is a broad, general outcome ("become the largest maker of bicycles" = goal; "increase sales by 2.5% each quarter" = objective). Small-business objectives: **profit maximisation** (ethically), **survival**, **growth** (economies of scale). Objectives can clash (governance vs profiteering; long-term investment hits short-term cash). [SM 495–496]
- **Culture** has no accepted definition; it rests on assumptions about human behaviour, legacy, the relation to the environment, appropriate emotions, effectiveness. Shared values: outcome, people and team orientation, attention to detail, stability, innovation, **praising failure**, aggressiveness; degree of **hierarchy** (high, moderate, low), urgency, people vs task orientation, functional orientation, **sub-cultures**. [SM 496–498]
- **Managing culture**: identify "artifacts" → convene employee groups from all levels → test the underlying assumptions → share findings → a **culture management action plan**. Founders' beliefs often go unchallenged though they may be outdated. [SM 499]

- SM WORDS **"Corporate Services"** = the service-oriented obligations of a corporate entity to **consumers, employees, shareholders, fellow businessmen, community and State**; the scope is a critical examination of the services rendered and of the enterprise's **awareness and responsiveness**. [SM 500]

Group	Scrutiny and evaluation criteria
Consumers	quality products, right quantity, price, place, time
Employees	pay, safety, welfare, industrial relations
Shareholders	safety of investment, fair return, capital appreciation
Community	social cost and benefit (social audit), public relations
Fellow businessmen	business ethics, fair trade dealings
State	spirit of the law, fair trade, taxes, service in emergencies

Means (customer relations, wise use of scarce resources, real social needs, fair prices, new products, stable employment, pre-empting legislation) → evaluation (better quality of life) → ends → **long-term profitability**. Questions: what a business **may**, **can**, **wants to** and **should** do. [SM 500–501]

11.3 Corporate development audit · Dec'24 Q7(b)

- **SM WORDS** Corporate development covers **potential** (structural build-up) and **kinetic** (organisation in action) aspects. The audit "approaches the structure and process of organisation, both in its potential and its transformation into kinetic energy": **unless an enterprise is structurally well equipped it cannot perform** its functions (size, technology, investment, product-mix, diversification, delegation, development of people). Being a going concern, it is a **continuous exercise**. [SM 502]
- Components: objectives (long, medium, short term) and plans (strategic, tactical, decisive) → **organisation development** (structural, functional, coordination, accountability) and **management development** (portfolio, succession, quality, personal development; personnel planning, industrial relations, participation); operation / system audit supports it. [SM 503–504]
- **Characteristics**: a multi-disciplinary team; planning and validation of decisions are the prime mover; achievements, failures, threats are the pointers; communication through a **"Point of Contact"**. External and internal environments. It assures that forces work for betterment, motivation and coordination are understood, and planning, coordination, motivation and control are discharged in the right spirit. [SM 505–506]

MODEL ANSWER · DEC'24 Q7(b): FOUR DIMENSIONS + SCOPE

Four essential dimensions: [SM 502–503]

1. **Regularity**: the different parts of the body corporate are under **constant watch**.
2. **Systematic check**: assessing the **changing requirements** of the corporate body in the context of forces from within and outside.
3. **Review**: assesses **past performance**, its quality and contribution to corporate goals; examines **deviations** and suggests measures.
4. **Appraisal**: examines whether the character and quality of the **goals match the resources employed against the attainments**; suggests the future course: **nothing is taken for granted, even goals**.

Scope (micro and macro): [SM 504–505]

1. **Corporate planning and policy**: long-term; strengths and weaknesses; product, production, finance, personnel, managerial **succession**.
2. **Corporate forecasting** (medium and short term): link of corporate plans with industry plans; market share; factors (demand, trends, competition, economy); match with national plans.
3. **Corporate strategy**: long term = will it survive as a viable entity? Short term = strategy on existing lines. Four dimensions of a strategic audit: product lines and competitive position; R&D and operations; financial analysis and management; top management.
4. **Corporate externalities**: economy, industry structure, technological obsolescence, socio-political-cultural environment.
5. **Corporate internalities**: organisation, management and personnel development and their sub-systems.

11.4–11.5 Personnel development · consumer services audit · Dec'23 Q7(b), MCQs

MODEL ANSWER · DEC'23 Q7(b) "HOW DO YOU EVALUATE PERSONNEL DEVELOPMENT?"

- The best, most loyal employees often **started near the bottom** and rose with their manager's help, support and encouragement: that is employee development; a well-managed company has **systems** for it, and managers trained in **coaching, feedback, mentorship**. [SM 507]
- **What managers should do**: delegate responsibility; honest, candid feedback; suggest specific development opportunities; motivate for risk and reward; show true **L.E.A.D.E.R.S.H.I.P.** (loyalty, empathy, accountability, determination, encouragement, respect, selfless, humble, integrity, passion). [SM 507]
- **Formal strategies**: general and specific **training**, soft skills (communication, negotiation, leadership) and hard skills (coding, accounting); **psychometric studies** for leadership roles. **Informal**: on-the-job training, **shadowing**, mentorship, coaching promising employees. [SM 507]
- **Performance evaluation**: annual appraisal against the **KRA**; goal setting; periodical review and mid-term changes; the aim is **feedback**. Tools: **rating scales** (numerical, ratings placed on a **bell curve** to find top performers); **360° feedback** (managers, subordinates and peers rate from every angle; wide view, but risky if the employee is unpopular or a supervisee is unhappy); **Management by Objectives** (actual vs objectives agreed the prior year, e.g. sales). [SM 507–508]

*Jun'23 MCQ: feedback from managers, subordinates and peers "from every angle" = **360° feedback mechanism**.* [SM 508]

- **Customer service** = the experience customers get when they interact with an organisation (business to business and business to consumer). Principles: respect for requirements, commitment, clear and accessible information, **well-trained customer-focused staff**, clear communication, earliest resolution of complaints, use of feedback. Good practice: surveys by independent parties, service levels vs targets, focus groups, results acted on, governance forum with **board-level updates**, KPIs, colleague feedback, all complaints and social media analysed. [SM 509]
- **Audit specifics**: is there a complaint registration process? a dedicated team? a documented complaints policy? is customer **WOW (wish on worth)** measured? any legal action for failing customers? are complaints **tracked** (patterns)? [SM 510]
- **Role of internal audit**: reasonable assurance to the board over customer service and complaint resolution; use risk metrics, complaints, product recalls, resolution time; include customer service in risk assessment and cyclical audits; satisfaction index; **Cost of Poor Quality (COPQ)**. Challenges: internal audit seen as "black and white"; conflict over how a complaint should be resolved; no direct access to customers; failure to judge requirements, missing data, unclear legal position. [SM 510]
- **SM MCQ keys**: consumer service audit examines management's **responsibility towards consumers** (= Dec'23 MCQ, postal) and is part of **social audit**. [SM 540]

11.6 Environmental audit · Dec'25 Q7(b) benefits

- SM WORDS Environmental audit is an **independent evaluation of policy and principles, systems, procedures, practices and performance** of a business relating to the environment. **ICC (1989)**, the accepted definition (also EMAS): **"a management tool comprising a systematic, documented, periodic and objective evaluation** of how well environmental organisation, management and equipment are performing, to help safeguard the environment by facilitating management control of environmental practices and assessing compliance with company policies". Also US EPA; CBI (1990): not "green-washing", a total strategic approach. [SM 511]
- **Features**: role of management (part of internal control; capex proposals); **EIA** predicts impacts of **upcoming projects** whereas the audit looks at **existing operations**; systematic and replicable; documentation; continuous review (root cause of deviations); objective evaluation (ISO 14001 needs independent repeat audits); environmental performance. [SM 512]
- **Objectives**: (i) determine and document **compliance status**; (ii) improve performance at facilities; (iii) assist facility management; (iv) raise **awareness**; (v) develop the environmental management control system; (vi) improve risk management; (vii) protect from **liabilities**; (viii) conservation policy; (ix) **fund allocation** (capex, opex); (x) a basis for optimising resources. [SM 513]
- **Four stages**: **pre-audit** (background, objectives, scope, criteria, team, **protocols**, inform the facility, desktop review) → **on-site** (opening, facility tour, inspection and evidence, interviews, findings, **exit conference**) → **post-audit** (final evaluation, major / minor findings, report to the Audit or Risk Committee) → **follow-up** (action plan with owner and date). [SM 514–516]
- **Report contents**: executive summary; background; objective and scope; observations (conformity, good practices, environmental costs and liabilities, staff awareness, overall status); recommendations; agreed actions with dates; criteria; evidence; isolated vs **chronic** problems. **Tools**: checklists, questionnaires (protocols), questioning (not interrogation), observation, photographs (with approval), research. [SM 516–517]

MODEL ANSWER · DEC'25 Q7(b) BENEFITS OF ENVIRONMENTAL AUDITING (SM ORDER)

1. **Improves the efficiency of the EMS**: assesses its performance, finds deficiencies, basis for improvement plans and corrective action.
2. **Compliance with environmental laws and standards**: the most important benefit, **cost-effective compliance**; avoids reputational risk.
3. **Risk mitigation**: a risk management tool for compliance with legislation.
4. **Meeting stakeholders' expectations**: reassures them; reputation as a **good corporate citizen**.
5. **Cost and environmental benefits**: cost-effective solutions (water treatment plant, solid waste equipment, alternate fuel), less operational inefficiency.
6. **Links operating processes to environmental impacts**: continual improvement, sustainability.
7. **Certification**: a step towards **ISO 14001**, Energy Star, LEED, FSC, Chlorine Free Products Association.
8. **Employees' awareness** of policy, health hazards, risks.
9. **Assists decisions**: an environmental database, investment decisions, competitive advantage, accreditation.

[SM 513–514]

11.7 Energy and utilities audit · MQP Q6(b), postal Q7(a) · the unasked favourite

- **Utility audit** = audit of utility expenses (electricity, gas, water / sewer): billing errors and savings, consumption monitoring. Electricity / gas checks: meter reading, demand basis, wrong rate or tax, multiplier, contract and tariff errors; water: meter reading, multiplier, surcharges, meter usage. Cost reduction depends on billing accuracy, consumption recording, compliance, **equipment age and power consumed**. [SM 518]
- SM WORDS **Energy Conservation Act, 2001**: energy audit is **"the verification, monitoring, and analysis of the use of energy including submission of technical report containing recommendations for improving energy efficiency with cost-benefit analysis and an action plan to reduce energy consumption"**. It balances total energy inputs with their use; it **assesses the usage**

MODEL ANSWER · KEY FUNCTIONS OF THE ENERGY AUDITOR (POSTAL Q7(a))

1. **Quantify** energy costs and quantities.
2. **Correlate trends** of production or activity to energy cost.
3. Identify **major energy-consuming equipment and processes**.
4. Identify **obvious inefficiencies and energy wastes**.
5. Identify areas for **further detailed investigation**.

[SM 520]

- **Types** (depend on industry and potential savings): **preliminary** = quick: establish consumption, estimate savings, find the **"low hanging fruits"** and no / low-cost savings, set a reference point, areas for detailed study,

pattern and **identifies saving opportunities**; it is the **1st step** of any energy management programme. [SM 519]

- **Phases**: analysis of historical consumption and cost data; preliminary audit (major consumers, obvious waste, priority areas). **Specific energy consumption** = energy per unit of production: monitors efficiency, sets targets, a standard, better cost allocation; a rise = loss of efficiency (ageing equipment, low production, breakdowns; or running beyond normal capacity; product-mix changes). [SM 519–520]
- **Measures**: short term (attitude of employees, routine maintenance); medium term (small investment on the fluid network, large on engineering); long term (interconnection of processes, changing the process principle). [SM 520]
- **Need**: energy, labour and materials are the three top operating expenses; it orients cost reduction, preventive maintenance and quality control; energy mix, conservation technology, retrofits; **"the translation of conservation ideas into realities"**. Primary objective: reduce **energy per unit of output** or operating cost; a **bench-mark** for managing energy. [SM 520–521]

uses existing data; **detailed** = full implementation plan, most accurate savings estimate, an **energy balance** compared with utility bills; in two phases. [SM 521]

- **Phase I, pre-audit**: an initial site visit (about one day): aims, economic guidelines, major consumption data, site drawings, a tour; to find main consuming areas, existing and needed **metering**, instruments, time frame, macro data, awareness. **Phase II, detailed**: checks at nights and weekends too; report of energy inputs and outputs by department, efficiency of each step, improvements with cost and **payback**, recommendations for engineering and feasibility studies. Data: consumption by source and department, material balance, tariffs, site services (steam, compressed air), sources of supply, fuel substitution and **co-generation**, energy management procedures; baseline: technology, capacity utilisation, inputs, water, fuel, electricity, steam, wastes, rejection %, yields. [SM 521–523]
- It answers **what to do, where to start, when to start, at what cost, and for what benefits**; helps cost optimisation, pollution control, safety. [SM 523]

11.8–11.10 Productivity and propriety audit · CSR audit · Jun'23 Q8(a), Dec'24 Q6(b)

- **Productivity** = output ÷ input (men, materials, machines, land, capital, energy, organisation); overall productivity needs **factorial productivities**. Content: **efficiency ratio** (actual production in standard hours ÷ actual hours worked) and **activity ratio** (actual production in standard hours ÷ budgeted production in standard hours). Express it by the major input (output per unit of raw material or electricity; labour by number, man-hours or wages; plant = capacity utilisation; capital = profit as % of capital employed). **Problems**: inputs have different units; inputs are inter-dependent; no unique mathematical solution. [SM 524–525]
- **Propriety audit**: audit of executives' decisions for **stakeholders' interest and financial discipline**, within sanction, authority, rule and law; it also investigates the **justification and necessity** of spending. Canons (benefit more than spent; no sanction to one's own advantage; public money not for a person or section unless insignificant, enforceable in court, or policy / custom; allowances not a source of profit). Examines estimates and excesses, avoidable delays, wasteful spending, recurring losses, comparison with similar schemes, targets on time, objectives met. **Limitations**: slows decisions; rule-bound thinking; useless if late. Used in government companies (C&AG) and in cost and financial audit. [SM 526–527]
- **Social cost-benefit analysis**: identifying and assessing benefits and costs of alternatives for economic and social goals; project appraisal ignores social costs (a labourer taken from agriculture). Purposes: measure future benefits, costs, net benefits, choose the best project. Essentials: objectives, benefits, costs (direct, indirect, imputed), present value. Techniques: **UNIDO** (social IRR), **Little and Mirrlees**, **Indian Planning Commission** (shadow exchange rate). [SM 532–533]

Other SM MCQ keys (SM 539–540): management auditor needs knowledge of all of financial accounting, production, costing · recommends information flow **internally and externally** · versed in MBE, MBO, delegation · **no time limit** for the management audit report · cost audit judges **internal**

MODEL ANSWER · CSR + THE INTERNAL AUDITOR (JUN'23 Q8(a), DEC'24 Q6(b))

Meaning: **s.135** + **Schedule VII** + the CSR Policy Rules, 2014 give the framework (SM MCQ 16: all three). Rule 2(1)(c): CSR includes projects in Schedule VII, or projects by the Board on the **CSR Committee's** recommendation under the declared CSR Policy. CSR is **corporate self-regulation** built into the business model, ensuring compliance with the spirit of the law, ethics and international norms: a company must give **more than profits** to shareholders. [SM 528]

Benefits: externally a **positive image** and respect among peers; internally **loyalty and trust** of employees; credibility with employees, specialists (analysts, rating agencies, government, NGOs), business partners (supply chain) and communities. [SM 528]

Internal auditors' involvement: (i) facilitate or advise on CSR **self-assessment**; (ii) **audit CSR programmes**, singly or as a broad review of whether CSR objectives are achieved; (iii) coordinate or take part in **CSR report verification**; (iv) check spending is in the **specified areas**. Roles: help **design and implement the CSR management system**; limited-scope audits for top management; **compliance audits**. Standards: **ISAE 3000** (assurance other than audits of historical financial information, IFAC) and **AA1000** (principle-based sustainability assurance). [SM 529]

- **Applicability** (preceding financial year): net worth **₹ 500 crore**, or turnover **₹ 1000 crore**, or net profit **₹ 5 crore** → CSR Committee of **3** or more directors, at least **1** independent (unlisted / private without IDs: none; a private company with **2** directors: both; foreign company: **2** persons). Committee: formulate policy, recommend amount, monitor. Board: approve and disclose the policy (website), ensure at least **2 %** of the average net profits of the **3** preceding years is spent, else give reasons; prefer **local areas**; net profit u/s **198**. [SM 529–530]

efficiency · management auditor's work begins **after the statutory auditor's ends** · useful for all of targets, assistance, staff relations · Leslie R. Howard: **highest level downwards** · corporate planning: **SWOT** · assurance: **three parties** (practitioner, responsible party, intended users) · no fixed evidence: relies on **experience and acumen** · report to the **management of the concern** · CSR applies to **every company**; turnover **₹ 1,000 crore**. [SM 539–540]

- **Schedule VII**: hunger and poverty, education, gender equality, environment, heritage, armed forces, rural sports, **PM CARES**, incubators and R&D, rural development, slums, disaster management. Routes: directly; own foundation; section 8 company or registered trust; others with a **3**-year track record; pooling with other companies. Unspent amount → **Unspent CSR Account within 30 days** of the year end (SM MCQ 20). [SM 530–531, SM 540]

⚠ SM MCQ 18 KEY IS WRONG · AND TWO RULES THE SM LEAVES OUT

SM MCQ 18 asks the **net worth** threshold and keys "₹5 crore"; the SM's own text (SM 529) and s.135 say net worth **₹500 crore** (₹5 crore is **net profit**). Not in the SM: since 2021, if the CSR obligation is up to **₹50 lakh** no CSR Committee is needed (the Board acts); unspent money not for an ongoing project goes to a Schedule VII fund within **six months** of the year end.

Module 12 · Evaluation of Corporate Image P17 · 12.1–12.4

SM pp. 543–570, exercise 571–576. **15 marks in 7 papers**, both as **Q7(a)**: ESG audit process (Jun'23, 8 marks) and **corporate image + strategy to build a positive image (Jun'26, from the ICMAI MQP)**. Q7(a) is otherwise IS audit (Module 13).

Paper	Question	Practice papers
Jun'23	Q7(a) **processes followed for an ESG audit** (8)	MQP Q7(a) **approaches to evaluate corporate image** (half of it came in Jun'26)
Jun'26	Q7(a) **what is corporate image? strategy to build a positive image**	postal Q8(a) **the Board's role in ESG strategy** (never asked)

DEC'26 PREDICTION · Q7(a), ABOUT 30% MODULE 12

- Slot model: corporate image (12.1) 15% · ESG (12.4) 10% · managerial-function checks (12.2) 5%. Write-first: the **six approaches + seven techniques** to evaluate image (MQP, only half used) and the **Board's role in ESG** (postal).
- MCQ facts from the SM exercise: slander · perception-oriented advertising · mass persuasion · image is built over years and maintained · BRSR for the **top 1,000** listed companies, mandatory from **FY 22-23**.

WHO MEASURES THE IMAGE, AND BY WHAT (SM 543)

Public	Measures it by
Customers	product quality, prompt after-sales service, regular supplies
Shareholders	consistent financial performance, growth prospects
Suppliers	liquidity, honouring commitments
Banks and FIs	financial health, net worth, debt-servicing history
Government	revenue generation, an honest tax payer
Employees	steady career growth, smooth industrial relations

12.1 Corporate image · evaluating and building it · Jun'26 Q7(a), MQP Q7(a)

- SM WORDS **"Corporate Image" is the reflection of an organisation in the minds of stakeholders and society at large**, i.e. its reputation; what the public sees when the corporation is mentioned. A good corporate image is a **genuine asset**: money at the counter and a higher stock valuation. Without effort it "simply happens"; management can shape it by communications, brands, symbols and publicising its actions; **the image should match reality**. Consistency needed in product quality, management ethics, employee relations, attitude and service to customers. [SM 543]
- **Elements**: (1) core business and financial performance; (2) **brand equity**; (3) innovation or technology; (4) policies towards employees and workers; (5) external relations with customers, stockholders, community; (6) perceived market trends; (7) the promoter or a charismatic leader. A **brief, casual act by an employee** can lift or damage it; the overall image is a composite of thousands of impressions. [SM 544]
- **Image vs images**: different publics see it differently (good brand, poor with suppliers who are paid late; loved on Wall Street, disliked where plants closed). **At the core: business performance**, the single most important factor; **Enron** (7th largest by revenue) collapsed on December 2, 2001 and its reputation imploded. [SM 544]
- **Measuring**: surveys (telephone most common), statistical extrapolation, plus "harder" measures (sales, stock performance); Toyota's US surveys. **Words and actions**: act first, then speak; employees as "a vast army of goodwill ambassadors". The image is built through brand names,

MODEL ANSWER · MQP Q7(a) APPROACHES TO EVALUATE CORPORATE IMAGE

A complex process: a critical examination of internal and external events and trends. The management auditor should: (1) list the **desirable attributes**; (2) classify them into **main groups**, each with its qualifications; (3) assign **weights** by importance; (4) involve **experts** to rate them on facts, judgements and technical studies; (5) **summarise** the ratings by group; (6) present a **composite evaluation** comparing actual with anticipated results. [SM 545–546]

Techniques: **graphical** (up-to-date graphs per attribute of each public) · **point** method · **index** method (ideal indices vs actual) · **survey** (questionnaires) · **ratio** method · **position analysis** (market size, share, stability) · **comparison** (actual vs budget; inter-firm comparison). [SM 546]

website, product quality, **prompt payment of bills**, promotions; it is tied to **reputational risk**. [SM 545]

MODEL ANSWER · JUN'26 Q7(a) STRATEGY TO BUILD A POSITIVE IMAGE

Open with the definition and the six publics (page 1). **Benefits** of a positive image: talented employees; help from institutions and banks; public subscription to shares and debentures; products sold against tough competition; government assistance; public sympathy in difficult times. [SM 546]

Methods: (1) **advertising** (TV reaches rural and tribal areas); (2) **quality products and customer service** build long-term loyalty; (3) **social amenities**: gardens, colleges, hospitals, temples, rural development, sponsorships, financial contributions; (4) **contribution in calamities** (wars, floods, drought, epidemics) is remembered gratefully. Close: you can fool some people all the time, or all the people some time, but **not all the people all the time**: the image must match reality. [SM 546–547]

12.2–12.3 Audit checks of managerial functions and corporate divisions (never asked long)

- **Managerial functions checked**: planning, organising, coordination, leading / motivating, controlling. Management audit scope here: study the organisation; search for performance shortcomings in economic function vs social responsibility, corporate structure, earnings growth, service to shareholders, R&D, constitution of the Board, fiscal and financial policies, operational effectiveness. [SM 548–555]
- **Divisional questions** for strategic business planning, organisation structure, finance and accounting, tax, budgeting, cash management, pricing and cost saving, purchasing, marketing, risk and insurance; Annexure I evaluations of purchase, personnel, production, R&D, sales, distribution (capacity configuration, staging of inventory, transport mode mix) and the **adequacy of budgetary control**. [SM 556–563]

SM MCQ keys: corporate image rests on industry goodwill, employee loyalty and shareholders' trust (all) · media norm "actual and factual" = **accuracy** · bottom-up communication starts with **employees** · business case for CSR: all · PR agency: all · investor relations: all · false or malicious spoken words = **slander** · PRO: all · advertising based on customers' experience = **perception oriented** · internal communication strategy: both · image is **built over years and then maintained** · mass communication = **mass persuasion** · project implementation: government incentives tied up · production: all · purchase: requisitions marked rush or emergency · inventory: review of A-category RM · finance: plans for modernisation and expansion · R&D: a separate department · insurance: timely renewals. True / false: 1 T, 2 T, 3 F, 4 T, 5 T, 6 F, 7 T, 8 F (Google), 9 T, 10 F (Federal Express). [SM 576]

12.4 ESG audit · BRSR · Jun'23 Q7(a), postal Q8(a)

- SM WORDS India introduced ESG reporting for the **top 1,000 listed companies by market capitalisation**: SEBI's **Business Responsibility and Sustainability Report (BRSR)**, mandatory from **F.Y. 22-23** (voluntary for 2021-22). [SM 564–565]
- **History**: India first to mandate **CSR** (Companies Act 2013; earlier the NVGs of 2011); SEBI's **BRR** for the top 100 listed companies in 2012, the top 500 in 2015; **BRSR** by circular of **May 10, 2021**, amending regulation 34(2)(f) of the LODR Regulations; based on the **nine principles** of the National Guidelines on Responsible Business Conduct (influenced by the UN Guiding Principles, SDGs, Paris Agreement, ILO). [SM 564–566]
- **BRSR disclosures**: general (material ESG risks and opportunities, goals, structures); environment (energy and water intensity, air emissions, **GHG Scope 1, 2 and 3**, waste, biodiversity: Principle 6); social: employees (diversity, turnover, median wages, welfare, safety, training: Principles 3 and 5), communities (impact assessment, rehabilitation, CSR: Principle 8), consumers (labelling, recalls, data-privacy complaints: Principle 9); governance (RBC training, anti-bribery, value-chain awareness: Principle 1). [SM 565–566]
- **E, S, G**: E = carbon, waste, resources, eco-friendly technology (also saves cost); S = employees, customers, communities (talent, loyalty); G = board diversity, executive pay, transparency, shareholders' rights. **Challenges**: complex regulation; scattered data (manual extraction; special GLs and cost centres); cost, esp. for small firms (incl. assurance); lack of ESG experts. **Merits**: reputation, risk reduction, saving money, long-term value. **Demerits**: implementation cost, **no standard framework**, short-term focus. [SM 567–568]
- **Adopting ESG**: (1) an **ESG strategy and a Sustainability Development Board** (vision and mission, strategy, measurable goals); (2) reporting templates; (3) investing (JP Morgan, Wells Fargo, Blackrock use ESG criteria); (4) global mandates. Reasons: brand, investors, recruitment and retention, operational effectiveness, regulation. Indian examples: ESG in top management **KRAs** (Marico), Vedanta, Tata group, Welspun; DJSI members Tech Mahindra, Infosys, Wipro; TCS and Reliance net-zero roadmaps. Abroad: UK (Companies Act 2006 regulations 2013), EU directive (2013), US SEC and NYSE, China (seven regulations; 2008 Act). [SM 568–570]

⚠ NOT IN THE SM · JUN'23 Q7(a) THE ESG AUDIT PROCESS (A FRAME TO WRITE)

1. **Scope and materiality**: agree objectives and the framework (BRSR principles, any global standard); identify the **material ESG issues** of the industry.
2. **Understand governance and policies**: Board / committee oversight, ESG policies, targets, responsibility owners.
3. **Understand the data systems**: how energy, water, emissions (Scope 1, 2, 3), waste, diversity, safety, complaints data are captured (often scattered and manual: SM 567).
4. **Test controls and verify KPIs**: trace samples to meters, invoices, HR and safety records; recompute intensities.
5. **Compliance check**: LODR regulation 34(2)(f) / BRSR, environmental and labour laws, CSR (s.135).
6. **Gap analysis and benchmarking** against peers and targets; risks and opportunities.
7. **Report and assurance**: findings, recommendations, an assurance or assessment statement where required (SEBI's BRSR Core, 2023, phased in for the largest listed companies).
8. **Follow-up** of the action plan with owners and dates.

⚠ NOT IN THE SM AS SUCH · POSTAL Q8(a) THE BOARD'S ROLE IN ESG STRATEGY

- Set the **ESG vision, mission and strategy** aligned to the business, with **measurable goals and targets** (SM 568: a Sustainability Development Board).
- Oversight structure: a **Board committee** (CSR / sustainability / risk) with clear charters; ESG skills on the Board.
- Integrate ESG into **risk management** and capital allocation; climate and supply-chain risk.
- Put ESG targets into **top management KRAs and pay** (SM 569: Marico).
- Approve **BRSR disclosures**; ensure reliable data and assurance; engage investors and stakeholders.
- Set the **tone at the top**: ethics, anti-bribery, human rights across the value chain.

Module 13 · Information Systems Security Audit P17 · 13.1–13.4

SM pp. 580–602, exercise 603–608. **45 marks in 7 papers. Q7(a), 7 marks, was an IS-audit question in every paper from Jun'24 to Dec'25** (Dec'23 had it as Q6(b), Jun'23 as Q7(b)); Jun'26 gave Q7(a) to corporate image instead. Answers are SM headings in SM order; the PTP answer copies SM 586.

Paper	Question	Paper	Question
Jun'23	Q7(b) **disruption of operations + business continuity planning** (8) · MCQ security in IS design	Jun'25	Q7(a) **role of cyber security in protecting data** (= PTP Q7(a) word for word)
Dec'23	Q6(b) **cyber security and computer forensics: the difference**	Dec'25	Q7(a) **steps in an IT security audit**
Jun'24	Q7(a) **IS audit approaches**	Jun'26	(Q7(a) went to corporate image, Module 12)
Dec'24	Q7(a) **IS auditor of a bank: maintaining data integrity**	Dec'26?	postal Q9(a) **pitfalls of inadequate security controls** (never asked) · postal: auditing with a computer

DEC'26 PREDICTION · Q7(a), 7 MARKS · ABOUT 70% IT IS IS AUDIT

- By the slot model: cyber security / forensics (13.3) 25% · IS audit in banks, approaches, BCP (13.4) 20% · security framework, pitfalls of weak controls (13.2) 15% · IT security audit steps (13.1) 10%. The other 30%: corporate image or ESG (Module 12).
- Write-first list: **pitfalls of inadequate controls** (postal, never asked) · **objectives of IS audit** · **IS audit methodology (5 steps)** · **business continuity plan + cold / warm / hot sites** · **RBI cyber security framework**.
- MCQ facts: three approaches · around = inputs vs outputs · audit trail localises the source of an error · firewall stops hackers · ACL · 90% of network problems are cable-related · effectiveness > 100%.

MAP OF THE MODULE

13.1 IT SECURITY AUDIT
5 steps: objectives → plan → perform → report → act

↓

13.2 COMPLIANCE FRAMEWORK
RBI: top-down governance, CSITE cell, baseline controls, levels 1–4

↓

13.3 CYBER SECURITY vs FORENSICS
prevention vs reaction

↓

13.4 IS AUDIT (BANKS)
4 objectives · 3 approaches · CAATs · 5-step method · framework A–F · BCP · KYC case

13.1 IT security audit · Dec'25 Q7(a)

- SM WORDS An IT security audit is a **comprehensive examination and assessment of an enterprise's information security system**; regular audits identify **weak spots and vulnerabilities**, verify security controls, ensure **regulatory compliance**. It verifies the security of hardware, software, services, networks and data centres. [SM 580]
- It answers: any weak spots? any tools that serve no security purpose? can we fend off threats and **recover after an outage or breach**? what action for the flaws found? Many laws require it for collection, use, retention and destruction of personal data. A **compliance audit** is done by a certified auditor of the regulator or an independent third party; staff may do an internal one. [SM 580]
- **Security audit vs risk assessment** (timing and scope): a **risk assessment** comes at the **start of an IT initiative**, before tools are deployed, and whenever the threat landscape changes (ransomware rise, remote working); it looks **outward**, to decide how to build the infrastructure. A **security audit** tests the **existing** infrastructure, at regular intervals. [SM 582]
- **Best practices**: clear objectives and scope; **buy-in from key stakeholders** (CSO, CIO, management sponsorship);

THE FIVE STEPS (THE DEC'25 ANSWER)

1. **Define the objectives**: goals with their business value, aligned to the company's goals. Which systems and services? Digital infrastructure, physical equipment, or both? Disaster recovery? A particular regulation?
2. **Plan the audit**: roles of management and IT administrators; schedule and methodology; tools for identifying, monitoring, reporting and **data classification**; logistics (taking equipment offline); **document and circulate** the plan.
3. **Perform the auditing work** per the plan: **scans** of file-sharing services, database servers, SaaS (e.g. Office 365) for network security, data access levels, **user access rights**, configurations; **physically inspect the data centre** for fire, flood, power surges; **interview employees outside IT** on security awareness and policy.
4. **Report the results**: formal report to management or the regulator: risks and vulnerabilities found + recommended mitigation.
5. **Take necessary action**: **remediation** of flaws; **training** in security compliance and awareness; best practices for sensitive data, **malware and phishing**; new technologies and regular monitoring.

clear **action items** from the results; audit the whole portfolio on a schedule. [SM 582]

[SM 580–581]

13.2 Compliance and security framework (RBI for banks) · pitfalls of weak controls

- Banking relies on electronic platforms, so **RBI expects banks to assess their cyber security preparedness**, with a **top-to-down approach** in information security governance: Board → IT and IS committee → down the hierarchy. Banks report to the **CSITE Cell** (Cyber Security and Information Technology Examination) of the Department of Banking Supervision: (1) **gap analysis** against the Cyber Security / Resilience Framework; (2) information security controls; (3) their **effectiveness**; (4) plan of action to mitigate risks; (5) role of the **CISO**. [SM 583]
- **How RBI audit is done**: in-depth technical assessment; information security process audit; applicability of cyber controls; **evidence and logs on servers**; all RBI technical norms. **Report**: detailed **gap analysis**; who must do what to comply, by which team or person. [SM 583]
- **Baseline controls** (selection): inventory of IT assets; preventing unauthorised software; application security life cycle; **patch, vulnerability and change management**; vendor risk; removable media; **audit logs**; network security; **user access control**; customer authentication; anti-phishing; **VAPT**; red team exercises; **incident response**; awareness; secure configuration; secure mail; **data leak prevention**; risk-based transaction monitoring. [SM 583–584]
- **By level**: Level 1 = baseline + vendor / outsourcing risk; Level 2 adds network, configuration, ASLC, change management, periodic testing, access, anti-phishing, DLP, logs, incidents; Level 3 adds advanced real-time threat defence and risk-based monitoring; **Level 4 = a Cyber Security Operation Centre (C-SOC)**, cyber drills, forensics and metrics, IT strategy, IS governance, CISO, Information Security Committee, **Audit Committee of Board**. [SM 584–585]

⚠ NOT IN THE SM: PITFALLS OF INADEQUATE SECURITY CONTROLS (POSTAL Q9(a), SM ESSAY Q7)

- **Unauthorised access** to data and programs (weak user IDs, passwords, access rights).
- **Loss or corruption of data** (no backup, untested restoration, virus attack, disk crash).
- **Fraud** at data entry and through **patch programs** that leave no audit trail.
- **Business disruption** with no business continuity plan; poor recovery.
- **Non-compliance** with laws and regulators (RBI framework, data protection) → penalties.
- **Loss of confidentiality** of customer data → reputation and competitive loss.
- Unreliable output (**GIGO**), wrong decisions; undetected errors with no audit trail.
- Policies not defined or not followed: controls "exist on paper" only (e.g. weekly password change not happening, SM 593).

Built from SM 589, 593, 597–598 and the SM's own MCQ 15 (protect against disasters, disgruntled or poorly trained employees, hackers, spies, data-entry operators).

*Jun'23 MCQ: security in the design of IS is used to **protect data and programs from accidental or intentional loss** (SM MCQ 14).* [SM 606, SM 608]

13.3 Cyber security and computer forensics · Dec'23 Q6(b), Jun'25 Q7(a), PTP Q7(a)

- SM WORDS **Computer forensics focuses on uncovering and preserving encrypted or lost data, while cyber security is about preventing data loss or cybercrimes from occurring. In short, one is reactionary while the other is preventative.** [SM 586]
- **Cyber security**: a professional discipline of **defensive measures against cyber attacks**; skills in programming, operating systems, networking; goal: a network **impossible to breach**. It is **almost entirely about prevention** (even ethical hackers only test and improve). Protocols: **user permissions**, **file transfer protocols (FTP)**, **secure, frequently changing passwords**; everyone must practise safe computer use. [SM 586]
- **Computer forensics**: **recovering data from a device**, often to uncover evidence of crime; **reactionary**, after the incident. Two purposes: **assist an investigation** (access to a suspect's laptop or phone; recover data in a way that does not violate the suspect's rights, so it is **admissible in court**) or **recover lost data** for a company (same processes, court rules not needed); may also identify the perpetrator. [SM 586]

	Cyber security	Computer forensics
Focus	**prevention**	**recovery and reaction**
When	before an attack	after an incident
Think of it as	a **security company**	**investigators**
Specialisations	systems architecture, software security, access management, ethical hacking, vulnerability assessment	criminal investigations; data recovery (also breach evidence)
Common aim	both protect data, programs, networks, digital assets; forensics also identifies the culprit	

SM 587. The ICMAI PTP answer to "role of cyber security in protecting data" = the SM 586 paragraph + **cyber hygiene**: strong passwords, software updates, user permissions, FTP, **multi-factor authentication**, training staff not to click suspicious links, **data backups**, **incident management**, VPNs, firewalls, **Zero Trust**.

MODEL ANSWER FRAME · JUN'25 Q7(a) "ROLE OF CYBER SECURITY IN PROTECTING DATA"

1. Definition: protecting systems, networks and data from unauthorised access, use, disclosure, disruption, modification; keeps operations running, protects sensitive data, prevents financial and reputational damage.
2. A discipline of **defensive measures**; almost entirely **prevention**.
3. **Access**: user permissions, strong and frequently changed passwords, MFA.
4. **Transfer**: secure FTP, VPN, firewalls, Zero Trust.
5. **Resilience**: backups, incident management.
6. **People**: everyone trained (phishing links); it is not one person's job.
7. Contrast in one line with computer forensics (after the event).

13.4 IT audit in the banking sector · objectives · Dec'24 Q7(a) data integrity

- SM WORDS IS audit identifies the **risks an organisation is exposed to in the computerised environment**, evaluates the adequacy of security controls and informs management; it is an **independent subset** of the normal audit, whose objectives do not change. **Four major objectives: (a) safeguarding IS assets, (b) data integrity, (c) system effectiveness, (d) system efficiency.** [SM 588]
- **(a) Safeguarding assets**: hardware, software, facilities, people (knowledge), data files, documentation, supplies; review physical security, systems software security, internal controls; hazards are **accidental** (fire, flood, power failure) or **intentional**. [SM 588]
- **(b) Data integrity** = safeguarding information against **unauthorised addition, deletion, modification or alteration** (records, backups, documentation). Eight features must not be compromised: **Accuracy, Confidentiality, Completeness, Up-to-date status, Reliability, Availability, Timeliness, Effectiveness**. Poor integrity = loss of true representation and competitive advantage. [SM 588–589]
- **(c) System effectiveness** = **actual output ÷ standard (budgeted) output**; above **100%** = effective. Goals: improved task accomplishment, improved quality, operational, technical and **economic effectiveness** (benefits exceed cost). [SM 589]
- **(d) System efficiency** = **output ÷ input**: minimum resources for the objectives; matters once there is no excess capacity. [SM 590]
- **Other objectives**: prioritise risks; IT per the Board-approved **Security Policy**; procedures adhered to; duties of system administrators; minimise computer abuse; improve controls; advise management; ethics and standards. **Scope**: all computerised offices; evidence on safeguarding, integrity, availability, effectiveness, efficiency; planning and monitoring of IS; IS staff. [SM 590]

MODEL ANSWER FRAME · DEC'24 Q7(a) "IS AUDITOR OF XYZ BANK: DATA INTEGRITY"

1. **Meaning**: safeguard data against unauthorised addition, deletion, modification, alteration; accurate data, securely transmitted. [SM 588]
2. **Check the eight features**: accuracy, confidentiality, completeness, up-to-date, reliability, availability, timeliness, effectiveness. [SM 589]
3. **Data input controls**: the most error-prone and fraud-prone area (routine work); evaluate minutely; control scanners and external media. [SM 597]
4. **Data processing controls**: only authorised officers run **start-of-day**; **day-end** with prescribed reports; authenticated record of database corrections. [SM 597]
5. **Patch programs**: bypass menu controls, **leave no audit trail**; only approved programs loaded (file name, size, date and time of compilation match the approved list); a record of each patch with reasons. [SM 597]
6. **Purging**: full backup first; never purge master data; purged media stored chronologically, in safe custody; manual record; access restricted. [SM 597]
7. **Backup and restoration**: regular; one set **off-site**; tested by restoring; labelled and numbered; restoration shows the data as at a date (detects tampering). [SM 597–598]
8. **Output and audit trail reports** (user ID of the operator and the authorising official for every change), **exception reports**, **version control** (licensed, listed programs), **virus protection**. [SM 598–599]

KYC solved case (CBS): data request for SB customer master (branch, customer and account ID, holders, address, PAN, mobile, phones, mode, balance) as text → import into **GAS** → **duplicate key test** (same PAN / mobile / address, different customer IDs) → check account-opening forms → **SOUNDEX** test on names (phonetic code: "Prasanna Iyer" = "P Alyer") → **de-dup**: several SB accounts of one customer in one branch = **red flag**. [SM 600]

13.4 IS audit approaches · CAATs · methodology · Jun'24 Q7(a)

THREE APPROACHES (THE JUN'24 ANSWER)

- **Around the computer**: check the **output against the input** without the processing details (SM MCQ 7); used when the auditor lacks technical skill, reliance is on **user (procedural) controls**, the system is **simple with a clear audit trail** (exception reports, batch input, low inherent risk, rarely modified), or a **well-tested generalised package** from a reputed vendor (not modified). Simple, but says nothing about coping with change; **not for complex systems**. [SM 591]
- **Through the computer**: the **programs and data are the target**; compliance and substantive tests on the OS, application and data; the computer tests logic and controls. Needs knowledge of the OS, hardware and systems development; **increases confidence** in the evidence but is **time-consuming**. [SM 591]

IS AUDIT METHODOLOGY: FIVE STEPS

1. **Planning**: understand the auditee and its processes, objectives, background, staff by skill, **areas of risk** (risk analysis: critical information, number and value of transactions); understand internal controls (previous reports, interviews, observation, documentation).
2. **Tests of controls** (management and application controls): **identification, implementation, existence** (e.g. weekly password change on paper but not done), **adequacy, documentation, maintenance** (fire extinguishers, UPS kept working), **monitoring** (supervision, surprise checks).
3. **Tests of transactions**: material misstatement from wrong transactions; objective = **data integrity**; trace journal entries to source, price files, computation, transaction log.
4. **Tests of balances**: final judgment on losses: confirm receivables, count inventory, **recalculate depreciation**; GAS prints confirmations.

- **With the computer**: the computer and its programs are **tools** for **substantive tests**; auditee data retrieved into an **independent environment** and interrogated with special programs. Used where (a) **large volumes** of input and output, (b) **complex logic**, (c) **substantial gaps in the visible trail**. [SM 591–592]

TOOLS (CAATs)

- **CAATs**: audit system files and evaluate internal controls where information is only on magnetic media; their papers kept **separate**; documentation describes the CAAT. **Audit software**, three types: **package programs**, **special purpose programs**, **utility programs** (sort, create, print). **Test data**: sample transactions entered, results compared with predetermined results. **General Audit Software**: most widely used, limited by staff skill; **ACL (Audit Command Language)**: flexible reports, auditor independent of IT experts, more coverage, saves time, money and effort, confidence in results. [SM 592]

5. **Completion**: opinion with findings and recommendations; **exit conference** with the auditee; draft report; final report after the auditee's responses; organised **work papers**.

[SM 593–594]

- Manual, computer-assisted and fully automated procedures, often combined; CAATs let the auditor test **every record** instead of samples. [SM 593]
- **Sub-system factoring**: break a complex system into sub-systems small enough to understand; evaluate each one's controls and its effect on the whole. **Management systems**: top-level, IS, systems development, programming, data administration, quality assurance, security administration, operations. **Application systems**: **boundary, input, communication, processing, database, output**. [SM 595–596]

13.4 Framework for IS audit · business continuity · Jun'23 Q7(b)

A. SAFEGUARDING ASSETS: WHAT THE AUDITOR INSPECTS

- **Environmental security**: server room strategically located, not easily accessible, for the server only. **UPS**: conditioned power, battery when electricity fails, maintained. **Electrical lines**: separate earthing for the dedicated line. **Data cabling**: experts estimate **90 percent** of network problems are **cable-related**; cable map; data and electrical cables must not cross. **Fire protection**: alarms, smoke detectors, extinguishers (water, carbon dioxide, Halon; gas replaces oxygen; water dangerous near live equipment; **no dry powder or foam**, they leave deposits). **Insurance**. **AMC** renewed in time, with a maintenance record. [SM 596]
- **Logical security**: user ID and password at OS and application level; check secrecy, access levels, creation and termination of maintenance users, login status reports, **dummy user IDs**. [SM 597]

B–F. THE OTHER CONCERNS

- **B. Data integrity** (input, processing, patch, purging, backup, restoration: see the Dec'24 frame). **Output reports: GIGO** (garbage in, garbage out); scrutinise reports on a sample basis; **audit trail report** with the operator's and authoriser's IDs; exception reports. **Version control**: licensed copies, complete list of programs. **Virus protection**: updated anti-virus, scan external media. [SM 598–599]
- **D. System effectiveness**: does it achieve the goals of computerisation, user-friendly? **E. Efficiency**: every asset used to maximum capacity. **F. Organisation and administration**: placement by aptitude and skill; **segregation of duties**, job descriptions, training, **dual control**, a system administrator with back-up; records of work, rotation, logins. [SM 599]

Vodafone (VOIS) case: to keep **PCI DSS** compliance for UK customer card data, VOIS needed **File Integrity Monitoring (FIM) and change control**; a first vendor's proof of concept failed after **2 months**; NNT's Change Tracker flagged harmful and unapproved changes without "change noise", giving continuous compliance and a faster audit. [SM 601–602]

C. BUSINESS CONTINUITY PLANNING (THE JUN'23 ANSWER)

- **Yes, disruption can occur**, from two types of problems: (1) **minor**: power failure, UPS failure, server failure, unreadable backups, cable fault; (2) **calamities**: natural (fire, flood, building collapse) or man-made (bomb blast, radiation, **virus attack**, induced data loss). [SM 598]
- A **BCP** is prepared to recover from such interruptions: **anticipating any disastrous event and planning for the business to live through it**. The auditor verifies its **existence and operability**, staff **awareness** of executing it, and comments on its effectiveness; it must be **documented and tested at regular intervals**. [SM 598]
- **Recovery horizons**: short term = essential systems and services restored; medium term = systems recovered temporarily; long term = **total recovery** of the processing environment. [SM 598]
- **Recovery sites**: **cold** = a room where equipment can be installed when needed; **warm** = room with equipment, software to be loaded; **hot** = the original installation **duplicated and ready**. [SM 598]
- The BCP sets out: responsibilities for recovery, how to reproduce media, location of backups, **priorities for recovery**, sources of replacement hardware and software, alternative communication. **Backup** is itself a BCP measure. [SM 598]

SM EXERCISE KEYS (SM 608)

1 **controls** ensure the system processes data as designed, results reliable · 2 (i) and (ii) · 3 (i), (ii), (iii) · 4 two-way check: (ii) and (iv) · 5 check-point: breaks programs into portions · 6 **audit**: inspect it is built as per specifications · 7 around = inputs vs outputs · 8 audit trail **localises the source of an error** · 9 with = auditing programs check a system · 10 testing = performing as per specifications · 11 **parallel runs** when first implemented · 12 viruses: (i) and (ii) · 13 **firewall** stops hackers · 14 **security** protects data and programs from loss (= Jun'23 MCQ) · 15 all six. [SM 608]

Module 14 · Internal Control and Internal Audit P17 · 14.1–14.3

SM pp. 613–631, exercise 632–634. **43 marks in 7 papers. Q8(a), 7 marks, is Module 14 or 15 in every paper since Dec'23** (Module 14 four times), plus 1–2 MCQs on internal check vs internal control. The MQP answer copies SM 613–615 word for word.

Paper	Question	Paper	Question
Jun'23	Q8(b) **engagement team discussions + documentation** · MCQ COSO components (supervision is not one)	Jun'25	Q8(a) **structure of internal control + factors in designing it**
Dec'23	Q8(a) **necessity of internal audit**	Dec'25	Q8(a) **internal control questionnaire: inventory**
Jun'24	Q8(a) **adequacy of internal controls** · MCQ checks and controls = internal check	Jun'26	MCQ internal controls vs internal checks (= Dec'24, word for word); Q8(a) went to operational audit
Dec'24	MCQ internal control **includes** internal checks; Q8(a) went to operational audit	Dec'26?	MQP Q8(a) **objectives of internal control + internal audit vs internal control** · MQP MCQs · PTP MCQ continuous audit

DEC'26 PREDICTION · Q8(a) 7 MARKS + MCQ

- Q8(a): Module 14 (chance about 45% for 14.1, 15% for 14.3) or Module 15. Write-first: **objectives of internal control + its differences from internal audit** (MQP) · an **ICQ for purchases or sales** (inventory came Dec'25) · **COSO components** · **limitations** · **types of control** · **audit committee's role**.
- MCQ (about 45%): internal check vs internal control (three times) · COSO's five · continuous audit · test checking needs an effective internal check.

THREE WORDS, ONE PICTURE

Internal control = the whole system (financial or otherwise) set up by management. It **includes internal check** (the work of one clerk automatically checked by another, while the work is done) and **internal audit** (an independent review after the work is done). So: control ⊃ check + audit (SM MCQ 2, 3).

INTERNAL CONTROL whole system → **INTERNAL CHECK** during the work → **INTERNAL AUDIT** after the work

14 Introduction · objectives · internal control vs internal audit · the MQP answer

- SM WORDS **Internal Control can be defined as the whole system of controls, financial or otherwise, established by the entity's management; which includes Internal Check, Internal Audit and other forms of control.** It ensures: effectiveness and efficiency of operations; protection of assets; prevention and detection of frauds and errors; accuracy and completeness of financial reporting; adherence to laws. **Five elements**: control environment, risk assessment, control activities, information and communication, monitoring. [SM 613]
- **Review methods**: narrative records, checklist, **questionnaire**, flowchart. [SM 614]
- **Internal audit** (IIA): an **independent, objective assurance and consulting activity designed to add value and improve an organisation's operations**; a systematic, disciplined approach to risk management, control and governance. Appointed by management / the Board; in listed entities the **Internal Audit Head is appointed by, and reports to, the Audit Committee**. [SM 614]
- **Objectives of internal audit**: accuracy and authenticity of records; standard accounting practices complied with; **early detection and prevention of fraud**; transactions recorded after due approval; liabilities only for business causes; review of internal control and report deviations. [SM 614]

MODEL ANSWER · MQP Q8(a) (SM 613–615 = ICMAI's answer)

Objectives of internal control: (1) transactions executed per management's **authorisation / policies**; (2) recorded in the **accounting period** to which they belong; (3) **assets protected** from unauthorised access and use; (4) **recorded assets compared with existing ones** at intervals and differences acted on; (5) **efficiency of performance** evaluated and weaknesses highlighted. [SM 613]

Key differences: [SM 614–615]

1. Internal control = **methods and procedures implemented by management** to control operations; internal audit **reviews the existence and effectiveness** of controls and suggests corrective action.
2. Internal control is a combination of **internal check and internal audit**; the internal audit function is designed by **those charged with governance**.
3. In internal control, checking is done **simultaneously** with the work; in internal audit, work is checked **after** it is performed.
4. Internal control aims at **compliance with management policies**; internal audit aims at **detection of fraud**.
5. The scope of internal control is **wider**: it includes internal audit.

14.1 Internal control: concept, COSO, objectives · Jun'23 MCQ

- SM WORDS Internal Controls are **systematic and procedural steps adopted by an organisation to mitigate risks**, primarily in financial accounting and reporting, operational processing and compliance with laws. The mitigation steps (review, approval, physical count, segregation of duty) are **"Control Activities"**. [SM 616]
- Names: **IFCs** (financial exposure) · **Operational Controls** · manual controls · **IT General Controls** (access) · **Application Controls** (sequential invoice numbers) · **Entity Level Controls** (code of conduct, part of the control environment) · **Process Level Controls** (order processing, payroll). An **Internal Controls Framework** is a benchmark to assess design, adequacy and operating effectiveness. [SM 616]
- **Responsibility**: under the Companies Act, 2013 the **Board of directors** (agents of the shareholders) must ensure appropriate controls and a culture of control. Procedures: physical controls over assets; authorisation and approvals; **segregation of duties**; management design; operational controls. [SM 616]
- **Internal audit and controls**: per **SIA 210** (ICAI) the Chief Internal Auditor plans scope and method, oversees assignments, manages staff and experts, communicates with stakeholders, keeps a quality programme. The internal auditor checks **design, implementation and operating effectiveness** of controls; an opinion follows **SIA 110** "Nature of Assurance"; reviews controls over **key risks** and **compliance** (incl. environmental standards). [SM 617]
- **COSO Internal Control-Integrated Framework: five components**: **control environment** ("tone at the top": the Board and senior executives), **risk assessment**, **control activities**, **information and communication**, **monitoring** (ongoing + periodic, e.g. internal audit). *Jun'23 MCQ: "supervision" is not a component.* [SM 618–619]
- COSO's definition: a **process, effected by an entity's board, management and other personnel, designed to provide reasonable assurance** regarding (1) effectiveness and efficiency of operations, (2) reliability of financial information, (3) compliance with laws. Sponsors: IIA, AICPA, FEI, AAA, IMA. Internal audit is part of **monitoring**. [SM 625]
- **Control objectives, three categories**: **operational** (performance reviews, physical security, training, supervisory sign-offs, division of duties) · **reporting** (authorisation, sign-offs, substantiation, **reconciliation**, passwords) · **compliance** (verification, evaluations, training, policy handbooks). [SM 619–620]
- **Audit objectives for transactions**: occurrence / existence, completeness, accuracy, classification, cut-off / timing, reporting and summarisation. Example, management authorisation of expenses: every expense authorised; records of authorisations kept; correct values; classified per protocol; true dates; shown in reports. [SM 620]
- **Process-level objectives**: authorisation, completeness, accuracy, **validity** (real, lawful events), physical safeguards, **error handling**, segregation of duties. [SM 630]

14.1 Scope, structure, design factors, types, benefits · Jun'25 Q8(a)

- **Scope**: an essential pre-requisite of efficient management; it embraces the **whole system of controls, financial, operational or otherwise**, incl. internal check and internal audit; beyond accounting control (quality control, work standards, budgetary control, periodic reporting, policy appraisals). Four categories: **administrative** (managerial, e.g. records of customers contacted by salesmen) · **operational** (budgetary control, standard costing) · **financial and accounting** (safeguard assets, prevent and detect fraud and error, accurate and complete records, timely reliable information) · **compliance**. [SM 621]
- **Types of control**: **preventive** ("prevention is better than cure"); **detective** (after the event: internal audits, reconciliation, financial reporting, physical verification); **input controls** (completeness, accuracy, existence, validity of data entered). [SM 622] The sum-up adds **corrective** controls (correct what was detected). [SM 629]
- **Benefits**: early warning system; prevents fraud; avoids external audit findings and regulatory fines. [SM 623]
- **Limitations** (only **reasonable assurance**): **judgment** under pressure; bypassing parameters by changing the process flow; overriding attitude; **breakdowns** (misunderstood instructions, mistakes, new technology); **management override** for personal gain (not the same as legitimate management intervention); **collusion**; **cost of controls must not exceed benefits** (e.g. an outside agency to verify daily cash at an outlet whose daily turnover is ₹1000); multiple controls at one point slow the process (maker-checker plus manual sign-off on POs). [SM 629]
- **COSO detail**: control environment = **ICHAMPBO**: Integrity and ethical values, Commitment to competence, HR policies, Assignment of authority, Management's philosophy, Board / Audit Committee participation, Organisational structure. Risk assessment: changed environment, new personnel, new systems, rapid growth, new technology, new lines, restructuring, foreign operations, accounting pronouncements. [SM 630] Control

MODEL ANSWER · JUN'25 Q8(a): STRUCTURE + DESIGN FACTORS

Structure: no uniform approach; it varies with (a) **type of business**, (b) **magnitude** of the business, (c) **infrastructure** available, (d) **potential of the human resources** and their outlook. [SM 621]

Design factors for a successful system: (1) **segregation of duties**: no one person handles a whole transaction; authorising and reconciling by different people; (2) **rotation of duties**, so fraud or error does not stay hidden; (3) **competence and integrity** of people; (4) **appropriate levels of authority**, on a need-to-have basis; (5) **accountability**: controls without strict action on every discrepancy give a **false sense of security**; (6) **adequate resources**; (7) **supervision and periodical updating** for a changing environment. [SM 622]

activities = **PIPS**: Performance reviews, Information processing, Physical controls, Segregation of duties. Information and communication: identify, describe, measure, record in the right period, present, communicate. [SM 631]

- **Weak controls, three management arguments**: one person does everything → use **compensating controls**; "too expensive" → compare with the **cost of a fraud**; "we trust our staff" → it is often the **most trusted employees** who commit frauds. [SM 631]

14.1 Responsibility, audit committee, evaluation, ICQ, adequacy · Jun'24, Dec'25 Q8(a)

- **Responsibility**: under clause **XIV** of CARO 2020, **Rule 18(3)** of LODR 2015 and **section 177(5)**, the **Audit Committee** must review internal controls and brief the Board; the **ultimate responsibility lies with the Board**. [SM 623]
- **Evaluation**: the auditor's time is limited, so the soundness of internal controls decides how deep he goes into routine checking. **Audit Committee** (s.177 + Rule 6 of the Meetings of Board Rules, 2014): every listed company and public companies with paid-up capital **₹10 Crores** or more, turnover **₹100 Crores** or more, or loans, borrowings, debentures or deposits exceeding **₹50 Crores**, as on the last audited statements. [SM 623–624]
- **s.177(5)**: the committee may call for auditors' comments on internal control, scope and observations; **s.177(6)**: power to investigate, seek information from any employee, outside advice. **Roles**: evaluate internal financial controls and risk management; review auditors' performance and adequacy of controls; review the internal audit function (structure, staffing, reporting, frequency); discuss significant findings; review internal investigations of suspected fraud; pre- and post-audit discussion with statutory auditors. It must review internal audit reports on control weaknesses and the **appointment, removal and pay of the Chief Internal Auditor**. [SM 624]
- **Internal control questionnaire**: a list of systematically and logically prepared questions to find out and evaluate the effectiveness of internal control; comprehensive; answered by the officials concerned with **"yes", "no", "not applicable", "explanatory notes" and "comments"**; yes = satisfactory, **no = weakness**. [SM 624]

⚠ THE SM'S CARO AND LODR REFERENCES

CARO 2020 clause 3(xiv) asks whether the company has an **internal audit system** commensurate with its size and business and whether the internal auditors' reports were considered; it has **no internal-control clause** (that reporting moved to s.143(3)(i), internal financial controls). The SM itself prints clause (xiv) this way in Module 15 (SM p. 658). "Rule 18(3) of LODR" is **Regulation 18(3)** read with Schedule II Part C. Write the SM text, then this correction in one line.

MODEL ANSWER · JUN'24 Q8(a) ADEQUACY OF INTERNAL CONTROLS (SM 659, MODULE 15)

Per **SA 200 read with SA 315**, the auditor understands the accounting system enough to identify major classes of transactions, how they start, records, documents and the reporting process. Financial and accounting internal control aims at: (i) **flow of work through stages**; (ii) **segregation of duties**, so no one person handles a job from beginning to end; (iii) **documentation** at each stage; (iv) transactions recorded with **proper amounts, on time**, per accounting policies; (v) **assets safeguarded**; (vi) **access restricted** to authorised persons; (vii) an **organisational chart** to fix responsibility; (viii) a system to **locate deviations and detect frauds and errors automatically**; (ix) **standardised records and formats**; (x) an efficient **MIS**; (xi) **minimum loss and wastage**. Adequacy and "major weakness" are **distinct**: no major weakness does not mean the system is adequate. [SM 659]

⚠ NOT IN THE SM · DEC'25 Q8(a) DRAFT ICQ: INVENTORY (ANSWER YES / NO / N.A. / NOTES)

1. Are purchases made only against **approved requisitions and purchase orders**?
2. Are goods received **counted, inspected and recorded on pre-numbered GRNs** by staff independent of purchasing and stores? Are GRNs matched with the PO and the invoice?
3. Are stores **locked, with access restricted**? Is a perpetual record (bin cards / stores ledger) kept and reconciled with the financial ledger?
4. Are **maximum, minimum and re-order levels** fixed and reviewed?
5. Are issues made only against **authorised material requisitions**; are returns to stores recorded?
6. Is stock **physically verified** periodically by persons **independent of the storekeeper**; are differences investigated and adjustments approved?
7. Are **slow-moving, obsolete and damaged** items identified and provided for; is valuation at **cost or net realisable value, whichever is lower**?
8. Are goods **held for or with third parties** recorded separately and confirmed?
9. Is inventory **adequately insured**; is scrap recorded and sold under control?

14.2–14.3 Internal control and the auditor · evolution and necessity of internal audit · Dec'23 Q8(a)

- **Role of the internal auditor in internal control**: (a) review of the system: does it give **reasonable assurance** that goals will be met efficiently and economically? (b) review of **effectiveness**: is it functioning as intended? (c) review of **quality of performance**: were goals achieved? (d) primary objectives of internal control: reliability and integrity of information; compliance with policies, plans, laws; **safeguarding of assets**; economical and efficient use of resources; accomplishment of goals. Management support is a must. [SM 626]
- **Evolution**: **Chanakya** (350-283 BC), adviser of Chandragupta, in the **Arthasastra** listed **40** types of embezzlement ("how much water the fishes drink"); Greeks, Romans, Egyptians audited; the first US Congress, **1789** (treasury secretary, comptroller, auditor); US **railroads** (travelling auditors) in the late nineteenth century; **Krupp**'s audit manual of **January 17, 1875**. Early aims: **protection of assets and detection of fraud**; a "psychological deterrent". [SM 627]
- The **1940s war economy** (cost-plus contracts) widened it to cost reporting; computers made checking every transaction unnecessary; **Arthur H. Kent**, "Audits of Operations", **March 1948**; operational outlook permanent by the **1970s**; aim moved from finding fraud to **helping management decide**. **Sarbanes-Oxley**: **Section 301** audit committee for listed entities; **Section 404** annual report on internal controls; CEO and CFO certify reports; similar provisions in the Indian Companies Act, 2013. [SM 628]

SM exercise keys: 1 several checks and controls = **internal check** (= Jun'24, postal) · 2 one clerk checked by another = **internal check** · 3 internal control **includes** internal checks (= Dec'24, Jun'26) · 4 not true of continuous audit: **"needed**

MODEL ANSWER · DEC'23 Q8(a) NECESSITY OF INTERNAL AUDIT (SM ORDER)

1. Helps management **strengthen internal controls** by uncovering system vulnerabilities and giving chances to fix them.
2. Aids in **discovering errors and frauds**, with corrective recommendations that prevent recurrence.
3. Acts promptly to curb **misuse of resources**, cutting unnecessary and **infructuous expenditure**.
4. Improves **workflow and processes**; a check on employee morale.
5. The **statutory auditor can rely on internal audit reports**, reducing audit time.
6. Its vigil keeps operating staff **on their toes**, keeping books updated.
7. **Independent review** of operations and business.

[SM 628–629]
Close with the definition: internal auditing gives **independent assurance** on governance, risk management and internal control, objectively, to improve business practices. [SM 628]

when internal control is good" (= PTP) · 5 an internal auditor is more concerned with the **internal control system** · 6 verification = establishing the **accuracy of entries** · 7 investigation: all of the above · 8 the auditor gives his **expert opinion** · 9 not a fraud risk factor: **conservative accounting principles** · 10 client acceptance: management that does not lack integrity. [SM 632–634]

⚠ NOT IN THE SM · JUN'23 Q8(b) ENGAGEMENT TEAM DISCUSSION (SM ESSAY Q4)

The statement is **correct**; it comes from **SA 315**: the engagement partner and key team members must discuss how **susceptible the financial statements are to material misstatement** (incl. fraud, **SA 240**) and how the reporting framework applies to the entity. Benefits: experienced members share their knowledge of the entity; the team understands where misstatement could arise; members see how their work affects others' areas; a basis for passing on new information during the audit. The partner decides what to tell members not present. **Documentation** (SA 315 with **SA 230**): the discussion and the significant decisions reached, kept in the working papers for review and future reference.

Module 15 · Operational Audit and Internal Audit P17 · 15.1–15.7

SM pp. 637–679, exercise 680–686. **24 marks in 7 papers. Operational audit was Q8(a) in Dec'24 and Jun'26** (Module 14 had Q8(a) in the other papers), and **MCQ (ix) was "role of CMAs / operational audit" in Jun'25, Dec'25 and Jun'26**. The ICMAI PTP answer copies SM 639–640.

Paper	Question	Paper	Question
Dec'24	Q8(a) **preparing for an operational audit + its objectives** (= PTP Q8(a))	Dec'25	MCQs: CMA in operational audit reviews **machine utilisation and production planning**; internal auditor = **any professional decided by the Board**
Jun'25	MCQs: internal audit is conducted **throughout the year**; operational audit focuses on **risk identification, process improvement**	Jun'26	Q8(a) **objectives, advantages and disadvantages of operational audit** · MCQ not a feature of operational audit = **transaction based**
Jun'23, Dec'23, Jun'24	—	Dec'26?	s.138 / Rule 13 never asked long; PTP MCQ internal audit throughout the year

DEC'26 PREDICTION

- **MCQ (viii)–(ix) is near certain**: role of CMAs 60%, operational audit 30%, s.138 25%, preparation 20%. Learn the **internal audit vs operational audit table** and the **Rule 13 thresholds**.
- Q8(a) 7 marks (shared with Module 14): preparation 10%, objectives / pros and cons 10%, **internal audit under s.138** 10% (never asked long: who must appoint, who can be appointed, procedure, penalty), CARO internal audit clause 5%.

INTERNAL AUDIT vs OPERATIONAL AUDIT (SM 652)

Internal audit	Operational audit
compliance objective	**risk identification, process improvement**
financial accounts focus	business focus
audit focus	efficiency and improvement focus
transaction-based	**process-based**
policies and procedures focus	risk management focus
cost-centre budget monitoring	accountability for improvement results
policies, transactions, compliance	goals, strategies, risk processes

15.1–15.2 Operational audit: meaning, preparation, objectives · Dec'24 and Jun'26 Q8(a)

- **Rule 13** (s.138) makes some companies appoint internal auditors (see 15.5); the IIA definition stresses **value addition**; understanding the entity's operations is the pre-requisite. [SM 637–638]
- SM WORDS **Operational audit** (residuary approach): **auditing which goes beyond financial transactions and accounting records and examines into the operating, managerial or administrative performance of the entity**; a **future-oriented, systematic, and independent evaluation** of all organisational activities. Objective: **improve the way the business performs**: lower costs, **decrease the turnaround time**, better service and customer satisfaction. It looks not only at how things are but **how things could be**. [SM 638]
- Also called **value-for-money audit**: an organised search for ways of improving efficiency and effectiveness; an **early warning system**. Financial audit says where the entity is; operational audit says **why it is there and how it got there**; it evaluates **planning, organising, directing and**

MODEL ANSWER · DEC'24 Q8(a) / PTP: PREPARING FOR AN OPERATIONAL AUDIT + OBJECTIVES

Preparation (Figure 15.1): there are an **active** and a **passive** approach in all audit assignments, especially operational audit, for a paradigm shift to **"beyond compliance"**: passive = detection, identifying problems; active = **prevention of wasteful activity**, promoting compliance with internal control, benchmarking processes against best practice, to **reduce revenue leakages and cost** → better business performance; from compliance to **strategic partner**. **Risk based audit** prioritises operational risk but does not give holistic coverage of the value chain; operational audit reviews **all** operating activities for the objective. [SM 639]

Objectives = DEMING (after W.E. Deming, TQM): **D**etailed understanding of the existing process to suggest improvement · **E**liminate waste and duplication · **M**erge operations to reduce turn around time · **I**mprove quality,

controlling; it is the primary domain of the internal auditor (financial and compliance audits are supplementary). [SM 652]

- **Triggers**: policy adherence, high sales returns, new product mix, equipment downtime, staff turnover. Set the **scope** first; understand the operations, history, image, workforce, **reporting path**; collect the organisation chart, policies, procedures and past performance reports (over- or under-staffing, control deficiencies, poor rotation); reports factual, timely, to the right level. [SM 653]

MODEL ANSWER · JUN'26 Q8(a) ADVANTAGES AND DISADVANTAGES

Advantages: **objective opinions** that bring quicker production by **lowering TAT** (turn around time), point out **process inefficiencies**, locate areas of **delay or lapses**, give **cost rationalisation / reduction**; a move towards **operational excellence**. **Disadvantage**: the mental fear of **"resistance to change"** in the organisational culture is the only one. (Add the objectives: DEMING, at right.) [SM 640]

volume, revenue · **N**ew methods, techniques, devices · **G**overn man, machine, methods and money. Auditors must spend more time on operation reviews; **"brain power"** replaces "brawn power"; the process integrates people, tools, procedures and technology. [SM 639–640]

Steps: (i) define the scope; (ii) knowledge of the business and processes, formulate the **audit programme**; (iii) evaluate accounting and internal control; (iv) nature, timing and extent of procedures (audit risk, materiality); (v) **documentation** (audit note book, working papers); (vi) opinion; (vii) report. **Techniques**: EDP for gaps, **process flow charting**, discussion. [SM 640]

15.2–15.3 Audit programme · continuous audit · working papers · note book · engagement letter

- **Audit programme**: a **written plan** with exact details of a particular audit; a memorandum of work; a guide against **omissions**. Factors for a detailed programme: previous internal audit observations and action taken; previous checklists; changes in commercial laws; special areas from top management. Contents: objectives per area; staff responsible; time per activity; detailed instructions. [SM 640–641]
- **Advantages**: a ready checklist; work allocated to assistants; progress known; individual responsibility fixed; uniformity; basis for next year; **evidence against a charge of negligence**. **Disadvantages**: work becomes mechanical; unnecessary for a small concern; staff hide behind "not in the programme"; no rigid programme fits every business (remedy: consult assistants, modify with experience). [SM 641–642]
- **Continuous audit**: detailed examination **throughout the year or at regular intervals** (fortnightly, monthly); suits early final accounts, **great volume of transactions**, or a **weak internal check** (SM MCQ: not true that it is "needed when internal control is good", Module 14). **Final (completed, periodical) audit**: after the year is closed. [SM 642]

- **Working papers**: formal documents of procedures, evidence and conclusions; a clear trail; reviewable by regulators and others; standardised; finalised at the end of fieldwork. **Permanent file** (MoA, AoA, agreements, internal control evaluation, ratios, previous statements, accounting policies, past observations, past cost and secretarial audit reports) vs **current file** (reappointment letters, minutes extracts, management letters, analysis of balances, communications, programme, conclusions, adjustments, reconciliations). They are the **property of the auditor**; safe and confidential custody. Retention depends on client agreement, firm policy, engagement, law, litigation. Advantages: evidence of due diligence, future reference, legal compliance, training, external reviews, record of adjustments. [SM 642–644]
- **Audit note book**: a bound book of matters observed; a **permanent record of the auditor**, one per audit: organisation, structure, MoA / AoA points, previous auditors, books kept, methods, controls, KMP, errors and frauds found, queries, points for the report, notes and ideas. Specimen columns: voucher no., account, amount, query, how disposed of. [SM 644–646]
- **Engagement letter**: written agreement on **scope, terms and conditions**, to the audit committee chair or board chair; sent to new clients and when terms change; preferably **before** the engagement. Contents: introduction; objectives (reliable information, compliance, inventory, physical verification, safeguarding assets, follow-up of prior reports); quarterly timetable; team; opening meeting; documents needed; draft observations to HODs, satisfied points dropped, the rest to the final report for the **Audit Committee**. [SM 647–650]

15.4–15.5 Role of CMAs · internal audit under s.138 · MCQs every paper

- **Role of internal audit and CMAs**: the Board expects help in identifying, monitoring and managing **business risks**

- **Who can be appointed**: producer company: a **Chartered Accountant** (s.378ZF); others: a **CA, a cost accountant, or**

(Enterprise Risk Management), insight on culture and ethics, efficiency of operations, compliance, reliable reporting, **safeguarding of assets**, advice; a risk-based plan linked to strategy; technology; business process re-engineering; governance. CMAs blend accounting, management and strategy: they judge operational efficiency, productivity, profitability, waste, **capacity utilisation**, production processes, supply chain, **utilities and energy**, sustainability (= Dec'25 MCQ: machine utilisation and production planning). [SM 651]

- **Legislative background**: first in the 1956 Act for producer companies (s.581ZF); made mandatory by **MAOCARO 1975**; MAOCARO 1988; CARO 2003; CARO 2016; CARO 2020; now **s.138**. [SM 654]

MODEL ANSWER · WHICH COMPANIES MUST APPOINT AN INTERNAL AUDITOR (s.138 + RULE 13)

a. every **listed company**;

b. every **unlisted public company** with, in the preceding FY: paid-up capital **50 crore** or more; or turnover **200 crore** or more; or loans or borrowings from banks / PFIs exceeding **100 crore** at any point of time; or deposits of **25 crore** or more at any point of time;

c. every **private company** with turnover **200 crore** or more, or bank / PFI borrowings exceeding **100 crore** at any point of time.

The internal auditor **may or may not be an employee**; the **Audit Committee or the Board**, in consultation with him, formulates scope, functioning, periodicity and methodology; the Act and rules give no duties. Existing companies: within six months (before 30th September, 2014). [SM 654–656]

another professional decided by the Board (SM MCQs 15 and 18). **Appointment**: only by a **resolution at a Board meeting** (Rule 8(4)), **not by circulation**; **MGT-14** within **30** days (dispensed for private companies, GSR 464(E), 05.06.2015). [SM 655]

- **Cannot be appointed**: the **statutory auditor** (MCA Circular 29 of 1976: the internal auditor is like an employee of management); the **cost auditor** for the period of his cost audit. [SM 655, SM 657]
- **Penalty**: s.138 has none, so **s.450**: **₹ 10,000**, plus **1 thousand** per day of continuing default, maximum 2 lakh (company) and 50 thousand (officer). **Procedure**: written consent → **7 days'** notice of the Board meeting → appoint at the meeting → inform him → MGT-14 within 30 days → intimation. [SM 656–657]
- **Sum-up facts**: IFSC public and private companies: s.138 applies only if the **articles** provide; objectives: protect stakeholders, avoid legal action, compliance and governance; scope: governance, risk, controls, reporting, compliance, **proactive fraud audits**; rights: access to books, information and explanations, check loans are secured; duties: wide audits, assurance and consulting, **annual plan agreed with the Chairman before Audit Committee approval**. [SM 677–679]
- **SM MCQ keys**: the financial auditor reports to **shareholders** · change in stock valuation: **allow with a note** · CAATTs = Computer Assisted Audit Tools and Techniques · no lien on the client's **books** · internal audit **throughout the year** (= Jun'25, PTP) · test checking needs an effective **internal check** (= MQP) · revenue treated as capital = error of **principle** · good internal auditor: right attitude, technical expertise, soft skills · s.138 "at any point of time" applies to **loans and deposits** · borrowings of **₹ 105 Crore** on 30.09.2022 trigger it. [SM 685–686]

15.6–15.7 CARO 2020 and internal audit · internal audit in manufacturing

- **CARO**: 2003 under s.227(4A) of the 1956 Act; s.143(11) of the 2013 Act; CARO 2015 (10 April 2015); **CARO 2020** published 25th February, 2020, applied from the year starting 1st April 2021. **Clause (xiv)**: (a) does the company have an **internal audit system commensurate with its size and nature**? (b) were the **internal auditors' reports considered** by the statutory auditor? [SM 658, SM 660]
- Terms: **internal control** (SA 200); per **SA 315**, internal audit is a component of internal control; **major weakness** (undefined: risk of significant loss or of material misstatement; judgment, materiality); **adequacy** is distinct from major weakness (see the Module 14 model answer); **continuing failure** = a weakness reported last year still existing, or one flagged at planning not corrected by the report date. [SM 658–660]
- **Exempt from CARO**: OPCs, small companies, banking and insurance companies, section 8 companies, and certain private companies. CARO 2020 has **21** clauses ((vi) cost records, (xi) fraud, (xiv) internal audit system, (xx) CSR, (xxi) subsidiaries' CARO remarks). [SM 660–661]
- **Manufacturing risk and control matrix** (Annexure I), production: plan vs sales and raw materials (budget, authority to change, shift data); **consumption norms** (BOM, reason-wise variance, controllable factors, material reconciliation); capacity vs the sales plan; documentation (daily report from DCS, authority to edit data in DCS / SAP); quality control (SOPs, sampling, complaints, rework approval, bagged only after QC); process losses and recycling; preventive vs breakdown maintenance; MIS from source data. [SM 662–664]
- **Contract workmen**: requisitions by skill and approved; competitive contractor selection; **ghost workmen** (ID with photograph, periodical "parole"); wage rates benchmarked. **Purchasing**: authorised advances; goods recorded at the **gate (Goods Inward Register) and the stores (GRN)**, reconciled; billing per quotation; issues on an approved **MRN**; stock levels and insurance. [SM 664–665, SM 674]
- **Solved cases**: (1) **high RM consumption variance**: BOM changed many times, a substitute RM without a BOM, one product code for two coatings, unequal month-end closing (25 to 31 days), BOM still assuming 10% handling loss after a conveyor cut it below 1%, multiple and unapproved BOMs. (2) **Inventory accumulation** (₹ 666 Crores against turnover of ₹ 5000 Crores): project surplus, stock of one plant invisible to another, old products' RM, warranty replacements booked as purchases, missing items, mixed-up piles, no stock levels, transit items,

⚠ THE SM'S CARO EXEMPTION LIST IS GARBLED

A private company is exempt only if it meets **all** of: not a holding or subsidiary of a public company; paid-up capital + reserves **not more than ₹1 crore**; borrowings **not more than ₹1 crore** at any time; revenue **not more than ₹10 crore**. The SM lists these as separate bullets and prints "more than ₹10 crores". The SM's small-company limits (₹50 lakh / ₹2 crore) are also old: see the P13 notes for the current limits.

materials sent out; actions: separate codes, view access before a PR, COO clearance for new products, stronger physical verification, bins, order levels, a **60 days** limit for transit items. [SM 674–677]

Module 16 · Audit of Different Service Organisations P17 · 16.1–16.10

SM pp. 690–713, exercise 714–720. **52 marks in 7 papers. Q8(b), 7 marks, is a service-organisation audit in every paper since Dec'23**, plus one MCQ. The ICMAI answers (PTP hospitals, MQP education) are the SM lists copied out: **learn each list in SM order**.

Paper	Question	Paper	Question
Jun'23	Q9(a) **co-operative society: overdue debts, valuation** (8)	Jun'25	Q8(b) **audit programme for NGOs**
Dec'23	Q8(b) **educational institution + students** · MCQ field balance sheet = SHG	Dec'25	Q8(b) **hotels: receipt and payment verification**
Jun'24	Q8(b) **self-help group: audit procedure**	Jun'26	Q8(b) **audit programme for hospitals**
Dec'24	Q8(b) **hospitals: points to consider**	Dec'26?	MQP Q8(b) **educational institution** · PTP Q8(b) **hospitals**

DEC'26 PREDICTION · Q8(b), 7 MARKS

- Most likely: **educational institution** (16.3, chance about 35%: the MQP asks it; last asked Dec'23). Then **co-operative society** (12%), hospitals, hotels, SHG, NGO (about 10% each), local bodies or government expenditure (never asked long, 5%).
- Q8(b) has never asked the same organisation in two papers running; only hospitals has come twice (Dec'24, Jun'26).
- MCQ facts: KOT = hotels · field balance sheet = SHG · s.17(2) of the 1912 Act · 10 persons · 20% · s.8 company · Art. 243J / 243Z · C&AG appoints · three types of government commercial entity.

HOW TO WRITE A 7-MARK "AUDIT PROGRAMME"

- One line of context (what the organisation is, what makes it risky: cash, grants, members, stock).
- Then **8–12 numbered steps in SM order**, each starting with a verb: *check, vouch, verify, reconcile, examine, ensure*.
- Always open with the **appointment letter / scope** and the **constitution documents and minutes**; always close with **physical verification**, **statutory compliance** and **fund / bank balances**.
- Add the one item unique to that body (KOT for hotels, overdue debts for co-operatives, field balance sheet for SHGs, FC bank account for NGOs).

16.1 Audit of hospitals · Dec'24, Jun'26 Q8(b), PTP Q8(b)

POINTS FOR A HOSPITAL AUDIT (SM ORDER = THE PTP ANSWER)

1. Check the **letter of appointment** to ascertain the scope of responsibilities (SM MCQ 9: the **first step**).
2. **Ownership and control** of the institution.
3. **Process** (admission, release, outdoor check-up, pathology and tests, operation theatre, vaccination) and related **controls till revenue generation**; facilities are normally given only on cash terms.
4. **Donations, special grants, interest, dividends**: validate with supporting documents; vouch with the **Investment Register** and interest and dividend warrants.
5. Ensure **purposive donations and grants** are spent for that purpose only.
6. Clear distinction between **capital and revenue** items.
7. Adherence to the **standard operating procedure** for expenses (capex and opex).
8. Verify the **internal check over purchases and issue of stores, medicines, medical equipment**.
9. Examine the **appointment of staff and visiting specialist doctors** and payment of salaries, to validate expenditure booking.
10. **Physically verify** investments, fixed assets and inventories.
11. Check **capitalisation and depreciation rates** and values in the books.

[SM 690]

MEMORY HOOK

Letter → Owner → Process → Donations → Purpose → Capital/revenue → SOP → Stores → Staff → Physical → Depreciation: **"LOP-DP-C-SSS-PD"**: the patient's path from admission to the asset register.

16.2 Audit of hotels · Dec'25 Q8(b) receipt and payment verification

- SM WORDS **Quality of service is the essence** of hospitality; the business handles **large amounts of liquid cash**, food stocks, many services, and must see that guests do not leave without settling dues. [SM 691]
- **(i) Internal control** must address revenue leakage, **pilferage** of food and utensils (one of the greatest problems), prompt collection, billing per tariff, issue and

A. RECEIPT AND PAYMENT VERIFICATION (THE DEC'25 ANSWER, SM ORDER)

a. Consumption in stock accounts **traced to customers' bills** (all issues billed).
b. Payments to the **foreign collaborator**, agency commission and payments to the **brand owner** as per the arrangement.

consumption control, bar licence, purchase at market rate. Check: (a) receipts and disbursements of cash; (b) purchase and stocking of provisions; (c) **billing of room service, telephone, laundry**; (d) custody of edibles, wines, cigarettes, crockery, cutlery, linen, furniture, carpets. [SM 691]

- **(ii) Room sales and cash collections**: grade-wise tariff (ordinary, luxury, super luxury) checked between Front Office and Billing Desk; room service and minibar billed; charge for rooms from the **guest register** for the exact stay; rate differences authorised; cards, cash, foreign exchange, cheques tallied with bills; **daily room occupancy report** and check-in/check-out validated; sales at each point reconciled with bills issued. [SM 691]
- Food bills with **KOT** (Kitchen Order Token) and the signed customer copy; resident guests' bills room-wise; all guests pay on leaving or within the set dates. [SM 692]
- **(iii) Stock**: utensils, food and beverages compared with kitchen records and **physically verified** (with or without surprise); stores locked, a shift-wise **key holding register**; no unauthorised persons; professional valuers; the auditor present for part of the count; Fixed Assets Register and depreciation. **(iv)** cost-centre records; **casual labour** records and wages. **(v)** cost-revenue per facility (pool, golf, spa). Also **statutory and FE (foreign exchange) compliance**. [SM 692]

c. Expenses and receipts **compared with the previous year**, given average occupancy and rate changes.
d. **Special receipts** (auditorium, banquet hall, shop space, boutiques, shows, marriage parties) verified with bookings.
e. **In-depth check of customers' ledgers**: all charges made and recovered.
f. **Occupancy rate** worked out and collection matched; rates **benchmarked** with similar hotels and the previous year; deviations investigated.
g. **Painting, decoration, renovation** expenses checked.
h. **Travel agents**: money recovered per credit terms; commission per agreement.
i. Control over **linen, crockery, cutlery, glassware, silver, toilet items**.
j. **Restaurant bills verified with the KOT**.
k. **All taxes** included in the bills.
l. **Salaries and wages** against the number of employees.

[SM 693]

16.3 Audit of educational institutions · Dec'23 Q8(b), MQP Q8(b) · the Dec'26 favourite

Ownership varies (government, private, trust), so the regulations differ. **Special steps**: [SM 694]

1. **Formation documents**: affiliation, management structure, governing body, ownership (for fund monitoring, donations, spending approval, affiliation fees). Examine the **Trust Deed or Regulations** (school or college) and note provisions affecting accounts; for a **university, the Act of Legislature** and its Regulations.
2. **Approving authority** for expenses, fund transfers, bank operation: read the **minutes** of the Managing Committee or Governing Body; check compliance, especially bank operation and sanction of expenditure.
3. **Student Register** semester- or class-wise (name, address, Aadhaar, guardian, contact) mapped to the **fee structure** (full, half, waiver); bank statements equated with fees receivable; **fee-book counterfoils reconciled** for counter collections; unpaid fees followed up.
4. Student Register updated for **discontinued, transferred students and drop-outs**.
5. **Fee condonation** by the proper authority considered in the receivable-received reconciliation.
6. **Admission and other collections** (late fees, transfer charges) tracked under proper heads.
7. **Hostel dues recovered** before students' accounts are closed; **caution deposits** adjusted or refunded.
8. **Other income**: rent with the **rent rolls**, FD interest with deposit certificates.
9. **Grants** with the grant papers; correct account head and **eligible spending** under the grant.
10. Review **Receipts and Payments and Income and Expenditure** accounts for completeness and accuracy of fund and bank balances.
11. **Statutory dues** (PF, municipal taxes, affiliation fees) and filings.
12. **Capital expenditure** vouched and checked with the committee's **sanction in the minute book**.
13. **Establishment expenses** vouched; enquire into any high-volume spending.
14. **Inventories** of furniture, stationery, clothing, provisions, equipment verified with the **Stock Register** and physically; values test-checked.
15. **Fund accounts**: dedicated bank balances tally with the books.

[SM 694–695]

DEC'23 ALSO ASKED "... AND THAT OF STUDENTS"

The student part = steps 3–7: Student Register vs fee structure, bank and counterfoil reconciliation, drop-outs, condonation, other collections, hostel dues and caution deposits. The ICMAI MQP answer uses the older wording: check names in the **Students' Fee Register** month by month; compare **receipt counterfoils** with the cash book; trace collections to the Fee Register.

16.4 Audit of co-operative societies · Jun'23 Q9(a)

- SM WORDS **Section 17(2)** of the Co-operative Societies Act, 1912 requires the auditor to examine the **overdue debts**, if any, and make a **valuation of the assets and liabilities**; he must also point out irregularities, improprieties and departures from the Act, rules and bye-laws. [SM 696]

SPECIAL FEATURES (SM ORDER)

1. **Overdue debts**: classify those overdue **six months to five years** and **more than five years**; good or bad; provision adequate; % of overdue debts to working capital and loans **compared with last year** (trend); recovery action and court cases. [SM 696]
2. **Overdue interest** is excluded from interest outstanding when calculating profit. [SM 696]
3. **Certification of bad debts** by the auditor where the law requires (Maharashtra Rule 49 of 1961: no write-off without it); otherwise the managing committee authorises. [SM 696, SM 700]
4. **Valuation**: no rule in the Act, so general accounting principles: fixed assets at **cost less depreciation** (incidental and installation costs capitalised; note market value if very different); current assets at **cost or market, whichever is lower**; all known liabilities in; contingent liabilities by note. [SM 696]
5. **Co-operative principles**: how far the objects are achieved (benefit to members, not profit); economy, no waste; avoid middlemen; **propriety audit**. [SM 696, SM 700]
6. **Infringements** of the Act, rules and bye-laws reported with their financial effect; some State Acts restrict dividends. [SM 697]
7. **Members' register and pass books**: loans and repayments confirmed in person (vital in rural credit societies with illiterate members). [SM 697, SM 700]
8. **Special report to the Registrar** on serious irregularities: personal profiteering by committee members; fraud in expenses, purchases, property, stores; mismanagement against co-operative principles; in urban co-operative banks, disproportionate advances to relatives of management and reckless lending. [SM 697]
9. **Audit classification**: the auditor awards a **class** on the Registrar's criteria; management may appeal to the Registrar. [SM 697]
10. **Discussion of the audit draft** with the managing committee before the report is final. [SM 700]

LAW AND MCQ FACTS

- **Any ten persons** may apply to the Registrar (**s.6**); bye-law changes valid only when the Registrar approves (**s.11**); no member may hold more than **20%** of the shares. [SM 697, SM 700]
- **s.17**: the Registrar audits, or has audited, every society **at least once every year**; the audit includes overdue debts and valuation; access to all books. The **Registrar appoints** the auditor; fees on the Registrar's scale, paid by the society; report goes **to the Registrar**, a copy to the society. [SM 698]
- **s.5**: in a limited-liability society no member (other than a registered society) holds more than **20%** of the capital or shares worth more than **Rupees one thousand**. **s.29**: no loan to a non-member without the Registrar's permission. **s.28**: Central Government may exempt from income tax, stamp duty, registration fees. [SM 701]
- **s.33**: first **25%** of net profit to the **Reserve Fund**; up to **10%** of the balance to charity with the Registrar's sanction; dividend not more than **6.25%**. [SM 702]

16.5 Audit of self-help groups · Jun'24 Q8(b), Dec'23 MCQ

- SHGs mobilise and empower rural people, especially **poor women**; low-cost financial services with self-management; formed with help from the Government or NGOs and linked to banks. Accountants are scarce at Gram Panchayat level, so the need is **"Community Audit"** by trained **"Community Auditors"**; ICMAI has an **MOU with WBSRLM** (West Bengal). [SM 703]

Assets	Liabilities
Cash in hand · cash at bank · loans outstanding with members · fixed deposit · fixed asset	Voluntary savings · external loan outstanding · equity: compulsory saving + **retained earning**

The field balance sheet (SM 703). Its **primary objective: ascertain the retained earnings** (SM MCQ 20).

FIELD BALANCE SHEET APPROACH (THE JUN'24 ANSWER)

1. **Background review**: preliminary examination of group records incl. the **cash book**; cross-check member **passbooks** for accurate entries and posting.
2. **Prepare the Field Balance Sheet** as on the audit date from the SHG's records and cross-check each item; objective: the **retained earnings**.
3. **Private meetings with members**: interview **25%** of members to triangulate and see how decisions are made.
4. **Meeting with the whole group** if serious issues arise.
5. **Reporting**: weak practices that put savings at risk or make records unreliable, with better methods; the Field Balance Sheet + summary report go to the **MFI/bank** and all members, to help credit decisions.

[SM 703–704]

16.6 Audit of NGOs · Jun'25 Q8(b) audit programme

- SM WORDS NGOs are **non-profit making organisations which raise funds from members, donors or contributors**, apart from donations of time, energy and skills, for social objectives. Formed as a **society** (Societies Registration Act, 1860), a **trust** (Indian Trust Act, 1882) or a **section 8 company** (Companies Act, 2013). [SM 705]
- **Planning**: (i) knowledge of the NGO's work, mission, vision, area, environment; (ii) legal form, MoA, AoA, rules; (iii) organisation chart, financial and administrative manuals, project guidelines, **funding agencies' requirements and formats**, budgets; (iv) **minutes** of the Board / Governing Body; (v) accounting system, internal controls and checks. [SM 705]

INCOME CHECKS

1. **Contributions and grants** checked with donors' agreements and grant letters; **foreign contributions deposited in the foreign contribution bank account** notified under the FCRA. [SM 706]
2. **Fund-raising receipts**: internal control, who collects, mode; collections counted and **banked daily**.
3. **Membership fees** with the membership register; entrance vs annual vs life fees; reconcile.
4. **Subscriptions** with the subscription register and receipts; reconcile with magazines dispatched; check rates.
5. **Interest and dividends** with investments held. [SM 706]

> ⚠ **FCRA: THE SM CITES THE 1976 ACT**
> The SM says "Foreign Contribution (Regulation) Act, 1976". It was replaced by the **FCRA 2010**; since the 2020 amendment every foreign contribution must first be received in the **"FCRA Account" at SBI, New Delhi Main Branch**. In the exam write the SM line and add "(now FCRA 2010)".

AUDIT PROGRAMME: EVERY ASSET, LIABILITY, INCOME, EXPENSE (SM ORDER)

1. **Corpus fund**: vouch with the donors' letters; interest with the Investment Register and investments in hand.
2. **Reserves**: transfers from projects with donors' letters and board resolutions.
3. **Ear-marked funds**: donors' conditions, board resolution, scheme rules.
4. **Project / agency balances**: disbursements per donor agreements.
5. **Loans**: loan agreements, counterfoils of receipts issued.
6. **Fixed assets**: acquisitions, disposals, depreciation and authorisations; donors' grant letters; title of immovable property.
7. **Investments**: register and physical check, **in the NGO's name**; approvals; principal and interest in the bank.
8. **Cash in hand** and imprest physically verified at year end.
9. **Bank balance**: reconciliation; old outstanding items.
10. **Stock in hand**: verify; management certificate for quantity and value.
11. **Programme and project expenses**: donor agreement conditions; for contracts, **TDS deducted, deposited, returns filed**.
12. **Establishment expenses**: PF, life insurance deducted and deposited on time; postage, stationery, travel.

[SM 705–706]

16.7–16.10 Local bodies · government expenditure · propriety · commercial accounts (never asked long)

- **Local bodies**: local self-government of villages, towns, cities: **Rural Local Bodies (Panchayats)** and **Urban Local Bodies (Municipalities)**. **Article 243J**: the State Legislature may provide for accounts and audit of **Panchayats**; **Article 243Z**: of **Municipalities**. [SM 707]
- **Financial administration** (SM MCQ 14: all three): (i) **budgetary procedure** (accountability, expenditure control, taxation levels, ceilings on revenue and capital spending); (ii) **expenditure control** (Council legislates, officers such as Commissioners execute; special items like tax reductions or deposit refunds need the Council); (iii) **accounting system**: traditionally cash, moving to accrual; subsidiary registers, separate vouchers, **compulsory monthly bank reconciliation**, periodic summary reports. [SM 707]
- **Objectives**: true and fair statements; detect and prevent error, fraud, misuse of funds; **full value for money spent**; legal and administrative requirements met. **Audit programme**: sanctions by the competent authority; spending per provisions and regulations; schemes run economically and achieve their purpose. [SM 708]

AUDIT OF GOVERNMENT EXPENDITURE (C&AG STANDARDS)

1. **Audit against rules and orders**: spending conforms to the statute and financial rules.
2. **Audit of sanctions**: every item covered by a general or special sanction of the competent authority.
3. **Audit against provision of funds**: funds provided and spending within the appropriation.
4. **Propriety audit**: brings out **improper, avoidable or infructuous** expenditure even if within the rules (SM MCQ 8: all of the above); wisdom, faithfulness, economy.
5. **Performance audit**: big programmes run economically and give the expected results.

[SM 709]

- **C&AG and a government company**: the **auditor is appointed by the C&AG**; under **section 143** the C&AG may (i) **direct the manner** of audit and instruct the auditor; (ii) conduct a **supplementary or test audit**; and may **comment upon or supplement** the audit report. [SM 709]
- *Not in the SM, from the Act:* s.139(5) appointment within 180 days of the start of the year; s.143(6) supplementary

- **Commercial accounts** (SM MCQ 13: **three** types): (i) **departmental enterprises** (defence factories, mints), audited like any department; (ii) **statutory corporations** (LIC, OMCs), audit per their statute; (iii) **government companies** under the Companies Act, 2013. [SM 711]

audit within 60 days of receiving the audit report.

- **Canons of financial propriety**: (1) spending not more than the **occasion demands** (the prudence of a person spending his own money); (2) no sanction to **one's own advantage**; (3) public money not for a particular person or section unless the amount is insignificant, the claim is enforceable in court, or it follows a recognised policy or custom; allowances must not be a **source of profit**. [SM 710]

SOLVED CASE · TOSHIBA, AN INTERNAL AUDIT FAILURE

Earnings inflated by at least **$1.2 billion** over **2009-2014**; the president and two predecessors quit in July 2015. Internal audit gave **consultation** to management and rarely did an **accounting audit**; unachievable targets ("Challenge") and pay of which **forty** to **45** per cent of the role part depended on performance pushed earnings management; the audit committee was neither capable nor independent (three outside members without finance knowledge; the ex-CFO the only whole-time member). Lessons: internal audit is primarily an **assurance** function, consulting flows from it; it needs an **independent, capable audit committee** to report to; it is the "**eyes and ears**" of the audit committee, so its failure is a governance failure. [SM 711–713]

SM EXERCISE KEYS (SM 718–720)

1 management audit **does not concentrate** on financial matters · 2 suggest improvement in methods · 3 **appraising** · 4 problem **identification** · 5 **non-routine** investigation (MCQs 1–5 are management-audit questions; see Module 9) · 6 **s.143** · 7 **section 8** of the 2013 Act · 8 all of the above · 9 **letter of appointment** · 10 **s.17(2)** · 11 **Article 243Z** · 12 **C&AG** · 13 **three** · 14 all of the above · 15 and 20: **SHG**, to find **retained earnings** (= Dec'23 MCQ) · 16 **KOT = hotels** · 17 **20**% · 18 **minimum 10** persons · 19 **foreign contribution bank account**. [SM 718–720]

Module 17 · Forensic Audit P17 · topics 17.1–17.5

SM pp. 727–762. **56 marks in 7 papers. Q5(b), 7 marks, in every paper since Dec'23** (cash embezzlement case, need and procedures, CFE code, techniques, investigation methodology, corporate fraud causes) plus an MCQ. Answers are SM lists: learn them in SM order.

Paper	Q5(b) · MCQ	Paper	Q5(b) · MCQ
Jun'23	Q10 **whistle-blowing policy** (8) · MCQ fraud tree	Jun'25	**forensic audit of finance + techniques**
Dec'23	**embezzlement of cash receipts: forensic approach** · MCQ management red flag	Dec'25	**investigation methodology** · MCQ primary objective
Jun'24	**need for forensic audit + procedures**	Jun'26	**corporate fraud: meaning and causes**
Dec'24	**code of ethics for CFEs**	Dec'26?	**meaning + common areas** (MQP Q5(b)) · **constituents** (PTP Q5(b)) — never asked

17.1 Forensic audit: meaning, methodology, need, areas · Jun'24, Dec'25 Q5(b)

- SM WORDS A forensic audit is an **analysis and review of the financial records** of a company or person to **extract facts, which can be used in a court of law**. It is an **independent, comprehensive, and scientific approach**; unlike financial audit (statutory compliance), it **investigates to derive evidence of fraud** for legal proceedings. The auditor may be an **expert witness**; it also covers bankruptcy disputes, business closures, divorces. [SM 727]
- Process = audit planning, gathering evidence, report + **possible appearance in court**. [SM 727]
- **Need** (Jun'24): (I) **theft of business information** or hacked systems; (II) issues from **whistle-blowers**; (III) **reconciliations with unidentified material differences**; (IV) **suspicion of fraud** or illegal activity; (V) turnover with negative balances. [SM 730]
- **Procedures**: with **professional scepticism** and a scientific approach, looking at **incentives**, **attitude** (rationalising) and **opportunity**. [SM 730]
- **Common areas** (MQP): **asset misappropriation**, **corruption**, **extortion**, **financial statement fraud**, **conflict of interest** (white-collar crime). [SM 731]

INVESTIGATION METHODOLOGY (DEC'25 Q5(b))

1. **Accepting the investigation**: an independent firm checks it has the **tools, skills and expertise** (fraud detection and legal framework) before accepting.
2. **Planning**: the key step; goals: identify the **type of fraud**, how long and how concealed; the **fraudsters**; **quantify the loss**; **evidence** for court; advice to **prevent recurrence**. Use the **fraud triangle**: pressure (motive), opportunity, rationalisation.
3. **Gathering evidence**: public documents and background checks · **detailed interviews** · trustworthy (confidential) sources · **surveillance** (physical or electronic) · **going undercover** (last resort) · analysing financial statements · analysing evidence.
4. **Reporting**: findings; summary of evidence; loss suffered; how the fraud was planned and unfolded; the trail of events; suggestions to prevent it.
5. **Court proceedings**: present facts simply and objectively.

[SM 727–730]

The nine-step fact-finding method: accept the engagement · evaluate the allegations · due-diligence background · preliminary investigation · assume **litigation** will follow · external investigation · gather proofs · report · court. [SM 731]

CONSTITUENTS OF FORENSIC AUDIT (PTP Q5(b))

1. assess **fraud risk factors**; evaluate internal controls and standards;
2. compare fraud **schemes** to devise controls;
3. develop **off-setting controls** to limit or prevent them;
4. **data analysis** to find high-risk transactions;
5. evaluate controls; plan audits using information systems;
6. evaluate financial and programme **risk**;
7. apply **evidence-gathering techniques**;
8. **justify the conclusion** of fraud with evidence for legal staff;
9. **document** the evidence and the process.

[SM 755]

CORPORATE FRAUD · WHY IT HAPPENS (JUN'26 Q5(b))

- SM WORDS Corporate fraud consists of **illegal or unethical and deceptive actions** committed either **by a company or an individual acting as its employee**; often complicated accounting schemes to **inflate apparent profits**; may take years to detect; much of the money is never recovered. [SM 731–732]
- **Causes:** (a) **greed** and the desire to **attract or retain investors** (look more profitable); (b) hiding **problems or defects with products** (e.g. drug side effects). Regulators: SEBI, the SEC. [SM 732]
- **Cases: Enron** (with Arthur Andersen; led to **Sarbanes-Oxley**); **Waste Management** (survived); **ZZZZ Best** (Ponzi); **Wirecard** (a $2 billion gap, 2020); **Wells Fargo** (sales quotas → fake accounts). India: Mundhra (LIC, 1950s), Harshad Mehta, Ketan Parekh, Sahara, Satyam. [SM 732–733, SM 736]

17.2 Fraud risk management · red flags · s.447 · Jun'23, Dec'23 MCQs

- **Fraud**: a **deliberate act (or failure to act)** to obtain an **unauthorized benefit** by deception, false suggestion or suppression of truth. Examples: embezzlement; forgery; altering computer files; fraudulent reporting; misuse of resources; paying for goods not received; unearned wages; conflict of interest. [SM 734]
- **Fraud triangle: opportunity** (weak internal controls: supervision, separation of duties, approval, system controls) · **pressure** (financial problems, addictions, unrealistic targets) · **rationalization** ("I'll pay it back", "they owe me"). **Breaking** it — above all removing **opportunity** through internal control — deters fraud. [SM 734–735]
- **Employee red flags:** lifestyle changes; heavy debt; behaviour changes; high turnover; **refusal to take vacation**; no segregation of duties. [SM 735]
- **Management red flags** (Dec'23 MCQ): frequent **override of controls**; decisions dominated by one person or a small group; disrespect for regulators; undocumented policies; weak control environment; many bank accounts; year-end transactions; refusal to use serially numbered receipts; missing documents; disputes with auditors; **frequent changes of auditors**; assets sold below market value. [SM 735–736]
- A suspecting employee should **not confront** the suspect or investigate personally. [SM 736]
- The 2013 Act: a separate definition of fraud in **s.447** and the **SFIO** under **s.212**. s.447 combines IPC s.405 (criminal breach of trust), 415 (cheating), 463 (forgery), 477A (falsification of accounts). Elements: act, omission, concealment, abuse of position with **intent to deceive**, gain undue advantage or injure, whether or not there is wrongful gain or loss. [SM 736–737]
- Fraud of at least **INR 10 lakh** or **1%** of turnover, whichever is lower: imprisonment **six months** to **10 years**; fine not less than the fraud amount; offence **cognizable, non-bailable, non-compoundable**. **s.446A** factors: size of company, nature of business, injury to public interest, nature of default, repetition. [SM 737]
- **s.143(12)**: auditors report fraud to the CG. **SEBI LODR** amendment from **October 08, 2020**: a listed entity discloses the **initiation of a forensic audit** (who, why) and the **final report** with management's comments — **no materiality threshold**. [SM 737–738]

*Jun'23 MCQ: the classification of frauds is the **fraud tree** (SM MCQ 14).* [SM 762]

17.3 Financial forensics and techniques · Jun'25 Q5(b), Dec'23 Q5(b) case

- **Financial forensics** combines **accounting and investigation** to find evidence of financial crime and recover losses; also values businesses. Cases: **financial theft** (e.g. from the cash register), **securities fraud**, **money laundering**, **valuation disputes**, **tax evasion**. [SM 739]
- Forensic accounting cross-checks records for fraud and gives court-ready analysis; it also cuts losses and improves efficiency. **Qualities:** logical mind; attention to detail; moral principles; **question everything**; spontaneity; understanding of transactions. [SM 740]

TECHNIQUES (SM ORDER)

1. reviewing **public documents** and background checks;
2. conducting **detailed interviews**;
3. information from **trustworthy sources** (protect identity);
4. analysing the **evidence** gathered;
5. **surveillance** (physical, electronic: e-mails, messages);
6. **going undercover** (last resort);
7. analysing the **financial statements**.

[SM 740–741]

Cash-embezzlement case (Dec'23): plan with the triangle; compare receipts books, bank deposits and ledgers; interview cashiers; check serial numbers and missing receipts; trace lapping; analyse the evidence; report loss, method, persons and control fixes. [SM 728–730]

17.4 Code of conduct · CFE standards and code of ethics · Dec'24 Q5(b)

ACFE CODE OF PROFESSIONAL STANDARDS

- Binds all **Certified Fraud Examiners** of the ACFE; Associates should follow it. [SM 749]
- **A. Integrity and objectivity**: never compromise integrity; screen and disclose **conflicts of interest**; objectivity; nothing discreditable; no false statement on oath; obey lawful court orders. **B. Competence**: accept only what one is competent for; continuing education. **C. Due care**: diligence, critical analysis, **professional scepticism**; evidence relevant, competent, sufficient; planning; supervision. **D. Understanding** with client on scope and limits. **E. Communication** of significant findings. **F. Confidentiality**. [SM 749–751]
- **Examination**: legal, thorough; consider **exculpatory and inculpatory** evidence; **chain of custody**. **Reporting**: oral

CODE OF ETHICS FOR CFEs (8) · THE DEC'24 ANSWER

1. commitment to **professionalism and diligence**;
2. no illegal or unethical conduct or **conflict of interest**;
3. highest **integrity**; accept only assignments he can complete **competently**;
4. comply with **lawful court orders**; testify truthfully, without bias;
5. obtain **evidence** for a reasonable basis; **no opinion on guilt or innocence**;
6. no disclosure of **confidential information** without authorization;
7. reveal all **material matters** discovered;
8. keep increasing **competence**.

[SM 751–752]

or written; not misleading; **no opinion on legal guilt or innocence**. [SM 751]

A CFE's three roles: identify evidence; interview and report; proactively evaluate **fraud risk**. [SM 752]

17.5 Professional opportunities · SM exercise

- Need: cyber-crime, regulators missing scams, failing co-operative banks; forensic accounting finds the **what, why and how** behind figures. **Maurice E. Peloubet** coined "forensic accountant" in **1946**. ICMAI runs an **Advanced Diploma in Forensic Audit**. [SM 753–754]
- ACFE 2018 Report to the Nations: **2690** cases from **125** countries, more than $7 billion lost; **72** from India. [SM 753]
- Indian cases listed by the SM: Vakrangee, Manpasand, Gitanjali (fake LCs), DHFL, IL&FS, Yes Bank, CG Power, ICICI Bank and others; solved case: **Harshad Mehta** (about ₹1,000 crore siphoned; ₹3,500 crore manipulated). [SM 754–756]

SM EXERCISE KEYS (SM 762)

1 forensic accounting = investigative and analytical skills to court standards · 2 fraud · 3 **juxtaposition test** · 4 senior management · 6 **phishing** · 7 **shot gunning** · 8 and 15 **rationalization** · 9, 11 **red flag** · 10, 12 **green flag** · 14 **fraud tree** (= Jun'23 MCQ) · 17 forgery · 18 ratio analysis: correct · 19 **3D vision**: time and space dimensions · 20 bank-fraud definition by **RBI** · 21–22 red flags, uncovering fraud → **forensic audit** · 23 fraud triangle · 24 fraud defined in **s.447** · 25 reporting duty **s.143(12)**. [SM 762]

Module 18 · Anti-Money Laundering P17 · topics 18.1–18.2

SM pp. 765–833. **53 marks in 7 papers. Q6(a), 7 marks, PMLA in every paper since Jun'24** (how ML works + offences, CDD + record keeping, ED, s.17 search and seizure, FIU-IND) and an MCQ (the "not in PMLA: **life imprisonment**" MCQ came three times word for word). The examined PMLA text sits in the module's introduction, **SM 765–772**; 18.1–18.2 are the FATF documents.

Paper	Q6(a) · MCQ	Paper	Q6(a) · MCQ
Jun'23	Q9(b) **records under PMLA + retention period** (8)	Jun'25	**Enforcement Directorate: responsibilities and powers** · MCQ life imprisonment
Dec'23	MCQ: not in PMLA → life imprisonment	Dec'25	**s.17 power of search and seizure**
Jun'24	**how money laundering works + offences** · MCQ up to 7 years	Jun'26	**FIU-IND: objectives and functions** · MCQ primary objective of AML
Dec'24	**customer due diligence + record keeping** · MCQ life imprisonment	Dec'26?	**s.18 search of persons + s.19 arrest** (PTP) · **AML compliance steps** (MQP) · attachment case (postal)

18.0 Money laundering and how it works · Jun'24 Q6(a)

- SM WORDS Money laundering is the practice of transferring funds gained through **illegal activities** like gambling, drug trafficking, corruption or embezzlement into a **legitimate source** in order to **conceal its true source**; dirty money is made to look clean. **AML**: what financial institutions do to comply with the law and **monitor and report suspicious activities**. [SM 765]
- US **Bank Secrecy Act 1970**; **FATF** formed in **1989** (after 9/11 also terrorist financing); IMF (**189** members). Laundered every year: **2% to 5%** of global GDP. AML = source of funds; CFT = destination of funds. [SM 765]
- Why institutions do AML: compliance; **brand and shareholder value**; avoid consent orders and penalties; cut costs of fines and risk capital. [SM 765–766]

THREE STAGES

1 PLACEMENT
illegal money **injected into the financial system**: cash businesses, false invoices, **"smurfing"** (small deposits below the threshold), trusts and offshore companies, foreign accounts

↓

2 LAYERING
separating funds from their source: complex layers of transactions across accounts and countries to hide origin and ownership

↓

3 INTEGRATION
re-entry into the economy as legitimate business or personal funds (real estate, luxury assets)

[SM 766]

PMLA Definitions, offence, punishment, attachment · the MCQ favourites

- **Proceeds of crime [s.2(1)(u)]**: any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a **scheduled offence**, or its value. **Property [s.2(1)(v)]**: assets of every description — corporeal or incorporeal, movable or immovable, tangible or intangible — and title deeds, wherever located. [SM 767]
- **Scheduled offence [s.2(1)(y)]**: Part A offences; Part B offences if the value is **Rs 1 crore or more**; Part C offences. [SM 767]
- SM WORDS **Money laundering (s.3)**: whosoever directly or indirectly **attempts to indulge, knowingly assists, knowingly is a party, or is actually involved** in any process or activity connected with the proceeds of crime and **projects or claims it as untainted property**. [SM 767]
- **Punishment (s.4)**: rigorous imprisonment **3 to 7 years** and fine; **NDPS Act** proceeds: not less than **3** years, up to **10** years. There is **no life imprisonment** in the PMLA (Dec'23, Dec'24, Jun'25 MCQ). [SM 768, SM 830–833]
- **Provisional attachment (s.5)**: by a **Director or an officer not below Deputy Director**, who records in writing his **reason to believe** that a person holds proceeds of crime likely to be concealed or transferred; valid **180 days**; order and material go to the **Adjudicating Authority**. [SM 768]
- **Adjudicating Authority (s.6)**: a **Chairperson and 2 other members** (one in law — qualified to be a District Judge or Indian Legal Service Grade I; one in finance, accountancy or administration); benches; term **5 years**, up to age **65**. [SM 768–769]
- **s.21 retention of records** seized under s.17/18: up to **180 days**; copies to the person; beyond that only with the AA's permission. **s.23**: if one of several interconnected transactions is proved to be ML, the rest are **presumed** part of it. **s.24**: presumptions and onus of proof. [SM 770–771]

s.16–19 Survey, search and seizure, search of persons, arrest · Dec'25 Q6(a), PTP Q6(a)

s.16 SURVEY · s.17 SEARCH AND SEIZURE (DEC'25)

- **s.16**: an officer may enter and survey premises to (1) inspect records, (2) verify proceeds of crime, (3) related transactions, (4) help other proceedings; he **records his reasons** and findings. [SM 769]
- SM WORDS **s.17**: a **Director or an officer not below Deputy Director** authorised by him, with information giving **reason to believe (recorded in writing)** that a person (1) committed money laundering, (2) holds proceeds of crime, (3) holds records relating to ML, or (4) holds property related to crime, may authorise a subordinate to: [SM 769]

a. **enter and search** any building, place, vessel, vehicle or aircraft;
b. **break open** locks of doors, boxes, lockers, safes, almirahs where keys are not available;
c. **seize** any record or property found;
d. place **identification marks**, make extracts or copies;
e. make a **note or inventory**;
f. **examine on oath** any person in possession or control of the record or property.

[SM 770]

s.18 SEARCH OF PERSONS · s.19 ARREST (PTP Q6(a))

- **s.18**: if the authority has **reason to believe (recorded in writing)** that a person has **secreted about his person**, or in anything under his possession, ownership or control, any record or proceeds of crime useful for PMLA proceedings, it may **search that person and seize** the record or property. [SM 770]
- **s.19**: the **Deputy Director, Assistant Director** or an officer authorised by the CG may **arrest** a person if, on material in his possession, he has **reason to believe** the person is guilty of a PMLA offence, the reason **recorded in writing**. Then he must: (1) **inform the grounds** of arrest; (2) send the **arrest order and material to the Adjudicating Authority**; (3) **produce the person within 24 hours** before the Special Court or a Judicial or Metropolitan Magistrate. [SM 770]

MEMORY HOOK

Every coercive power needs a **"reason to believe, recorded in writing"**: s.5 attach (180 days) · s.16 survey · s.17 search premises · s.18 search persons · s.19 arrest (24 hours) · s.21 retain records (180 days).

INDIA FIU-IND, ED, RBI, SEBI · Jun'26 + Jun'25 Q6(a)

FIU-IND (JUN'26)

- Set up by O.M. dated **18.11.2004** as the **national agency** to **receive, process, analyse and disseminate** information on suspect financial transactions; coordinates national and international intelligence, investigation and enforcement agencies; **independent**, reporting to the **Economic Intelligence Council** headed by the **Finance Minister**. [SM 771]
- **Functions:** (1) **collection**: central reception of **CTRs, NTRs, CBWTRs, IPRs and STRs**; (2) **analysis** to find patterns of ML; (3) **sharing** with intelligence, enforcement, regulators and **foreign FIUs**; (4) **central repository** (national database); (5) **coordination**; (6) **research and analysis** of trends and typologies. [SM 771–772]

ENFORCEMENT DIRECTORATE (JUN'25)

- **Responsibility**: enforce the PMLA by **investigating to trace assets** derived from proceeds of crime, **provisionally attaching** property, ensuring **prosecution** of offenders and **confiscation** by the Special Court. [SM 772]
- **Powers**: (1) **penalty on reporting entities** for non-compliance; (2) provisional attachment · survey · search and seizure · search of persons · arrest · retention of property · retention of records. [SM 772]
- **RBI**: guidelines on **CDD, EDD**, transaction monitoring and reporting. **SEBI**: PMLA in securities transactions. Insurance, pension and other regulators in their domains. [SM 772]

18.1 FATF Recommendations: CDD, record keeping, STR · Dec'24 Q6(a), Jun'23 Q9(b)

R.10 CUSTOMER DUE DILIGENCE

- **No anonymous or fictitious accounts.** CDD is required when: (i) **establishing business relations**; (ii) **occasional transactions** above **USD/EUR 15,000**, or wire transfers; (iii) **suspicion** of ML/TF; (iv) **doubts** about earlier identification data. [SM 776]
- **Measures:** (a) **identify and verify the customer** from reliable, independent documents; (b) **identify the beneficial owner** and understand ownership and control; (c) understand the **purpose and nature** of the relationship; (d) **ongoing due diligence** and scrutiny of transactions, incl. **source of funds**. Extent decided on a **risk-based approach**. [SM 776–777]

R.11 RECORD KEEPING · R.20–21 · R.29

- SM WORDS Keep, **for at least five years**, all necessary records on transactions, domestic and international, sufficient to **reconstruct individual transactions** (amounts, currency) as evidence; keep **CDD records** (passports, ID cards, driving licences), account files, business correspondence and results of analysis; make them available to authorities. [SM 777]
- **R.20**: report suspicions **promptly to the FIU** (STR). **R.21**: protection for **good-faith** reporting; **no "tipping-off"**. **R.29**: an FIU as the national centre for STRs and other information. [SM 780, SM 783]
- FATF has **40** recommendations (SM MCQ 18) in groups A–G: policies and coordination; ML and confiscation; terrorist

- Verify **before or during** onboarding; if CDD cannot be done: **do not open** the account or **terminate** the relationship and **consider an STR**; apply to existing customers on materiality and risk. [SM 777]

financing; preventive measures; transparency of legal persons; powers of authorities; international cooperation. [SM 774–777, SM 833]

⚠ PMLA'S OWN RETENTION RULE (NOT IN THE SM)

For Jun'23 Q9(b) write the Act too: s.12 PMLA — reporting entities keep records of transactions and of client identity for **five years** (transactions: from the date of transaction; identity: after the business relationship ends), and furnish information to the Director (FIU-IND).

18.2 Risk-based approach for accountants · the AML compliance steps (MQP Q6(a))

1. **Risk assessment** of the firm and each client (country, client, service risk).
2. **Client due diligence**: identify and verify the client and the **beneficial owner**; source of funds and wealth; refresh on a change in identity, ownership, services, location, wealth, business, or on watch-list hits.
3. **Additional requirements**: record keeping; assessing new products and technologies; reliance on third parties; STRs; internal controls (employee screening, training, independent audit); a **Compliance Officer** at management level; high-risk countries; staff training.
4. **Ongoing monitoring** (R.10 and R.22): regular review of client activity against the initial risk rating.
5. **Reporting suspicious transactions** (R.20): appoint a CO or **MLRO** to file STRs (red flags: indifference to losses, unexplained foreign transfers, cash inconsistent with the profession, unidentifiable deposits).
6. **Internal controls and compliance** (R.18 and R.23): Board-approved policies; training; regular review of risk assessment; **designate a Compliance Officer** and run a compliance programme.

[SM 789–790]

SM EXERCISE KEYS (SM 829–833)

1 PMLA 2002 = **Act No.15 of 2003** · 2 in force **1st July 2005** · 3 financial institution includes all listed (chit fund, housing finance, payment system operator, NBFC, Department of Posts) → none excluded · 4 payment system: cards and money transfer — all · 5 "person": HUF, AOP, artificial juridical person — all · 6 precious metal excludes **diamond** · 7 precious stone excludes **graphite** · 8 offence **s.3** · 9 punishment **s.4** · 10 not in PMLA: **life imprisonment ★** · 11 up to **seven years** · 12 NDPS-linked: **ten years** · 13 attachment **180 days** · 14 **thirty days** · 15 **Adjudicating Authority** · 16 FATF set up by the **G7** · 17 in **1989** · 18 **40** recommendations · 19 **10** · 20 **FIU**.

[SM 829–833]

Number	Rule
3–7 years · NDPS 3–10 years	s.4 punishment
Rs 1 crore	Part B scheduled offence
180 days	attachment (s.5); record retention (s.21)
24 hours	produce the arrested person (s.19)
chair + 2 · 5 years · 65	Adjudicating Authority
USD/EUR 15,000 · 5 years	FATF occasional-transaction CDD · record keeping
18.11.2004	FIU-IND set up