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]