RNSIT-VTU-III SEM MBA

STRATEGIC COST MANAGEMENT

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CBCS Scheme

Module-5

Cost Audit & Reporting to Management

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COST MANAGEMENT

Module-5

Cost Audit & Reporting to Management-objectives and advantages of Cost Audit, Cost Audit report. Management Audit- Objectives and Scope. Reporting to Management – Purpose of reporting-Requisites of a good report, Classifications of Report, Segment reporting, Cost Reduction and Cost Control, Target Costing – its Principles, Balanced Scorecard: Features and Purpose (theory only).

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Audit

In General Audit is an evaluation of a person, organization, system, process, enterprise, project or product. In Accounting Audit is the examination and verification of a company's financial and accounting records and supporting documents by a professional, such as a Charted Accountant.

Why are Audits Performed?

Audits are performed

- To ascertain the validity and reliability of information
- Also to provide an assessment of a system's internal control

Auditor

Auditor is an official whose job it is to carefully check the accuracy of business records

Two types of auditors:

- Internal Auditors:
  - Employed by the organization they audit.
  - They perform various audit procedures, primarily related to procedures over the effectiveness of the company's internal controls.
- External Auditors(Statutory auditor):
  - An independent Public accounting firm engaged by the client subject to the audit, to express an opinion on whether the company's financial statements are free of material misstatements.

Concept of Cash Audit And Cost Audit

Cash Audit

Audit of cash receipts and payments only is known as cash audit. Auditor should be careful while conducting cash audit because there are chances of frauds. An auditor should check in detail all the documents, voucher and books of accounts while conducting cash audit. An auditor should provide suggestions to the client in the report after finding out the position of cash to conduct various programs and to prevent misuse of cash. Its report is to be presented to the appointing authority.

Cost Audit

The term 'cost audit' refers to the audit of cost records. The cost auditor is appointed to check the cost accounting records in order to ascertain their accuracy and also to ensure that cost accounting plan as laid down by the company is carried out. Cost audit is an audit of actual performances. Cost audit acts as an effective managerial tool for the detection of errors, frauds, inconsistencies and irregularities in cost accounting records. Cost audit is different from the financial audit as the latter is an examination of financial books and records in order to see whether or not the financial statements represent a true and fair view of the state of affairs of the organization while the former is the verification of cost accounts and a check on adherence to the cost accounting plans.

Definition of Cost Audit

Cost audit has been defined by CIMA, London as “the verification of cost account and a check on the adherence to the cost account plan”. The institute of cost and work accountants of India (ICWAI) defines “cost audit of efficiency of minute details of expenditure while the work is in progress and not a post mortem examination...”

Financial audit is a fait accompli. Cost audit is mainly a preventive measure, “guide for a management policy and decision, in addition to being a barometer of a performance.”

Objectives of Cost Audit

1. To establish the accuracy of costing data. This is done by verifying the arithmetical accuracy of cost accounting entries in the books of accounts.

2. To ensure that cost accounting principles are governed by the management objectives and these are strictly adhered in preparing cost accounts.

3. To ensure that cost accounts are correct and also to detect errors, frauds and wrong practice in the existing system.

4. To check up the general working of the costing department of the organization and to make suggestions for improvement.

5. To help the management in taking correct decisions on certain important matters i.e to determine the actual cost of production when the goods are ready.

6. To reduce the amount of detailed checking by the external auditor if effective internal cost audit system is in operation.

7. The protection of the business. It deals with proper ascertainment and control of cost by -

Detecting errors or ensuring that cost records or compiled correctly;

- Checking accuracy of records in order to verify that cost account or correctly maintained in conformity with accepted cost accounting principles adopted in the industry;
- Ascertaining whether procedures and routines as laid down by the management are properly and uniformly followed.

8. Comparison of cost. Comparison of the actual cost for the year with the cost pertaining to previous year or years to ascertain whether cost has increased or decreased as compared to the cost of the previous year or years. Comparison of the actual cost with the standard cost is made to know the reasons for the variances.

What are the situations under which cost audit is ordered**?**

i. When the management wants to detect the errors, frauds, irregularities and inconsistencies.
ii. Sec 233-B of the Companies Act, 1956, has made cost audit compulsory in certain specified companies to be notified by the Central Govt from time to time.
iii. While fixing an appropriate price for the product
iv. When management wants for inter-firm comparison
v. When shareholders are not getting a fair return on their investment
vi. When management wants to reveal the facts and figures to maintain transparency.

Advantages of Cost Audit

A. To the Management

1. Cost audit provides reliable cost data for managerial decisions: It will bring more reliability on the costing data and hence can be more effectively used for inter firm comparison.

2. Cost audit helps management to regulate production. It will help in reducing the cost of production because a close check will be maintained on all wastages relating to materials, labour and overhead.

3. Cost audit acts as an effective managerial tool for the detection of errors, frauds and irregularities so that reliable and smooth functioning of the system is continued.

4. Cost audit reduces the cost of production through plugging loopholes relating to wastage of material, labour and overheads.

5. Cost audit can fix the responsibility of an individual wherever irregularities or wastage are found.

6. Cost audit improves efficiency of the organization as a whole and costing system in particular by constant review, revision and checking or routine procedures and methods.

7. Cost audit helps in comparing actual results with budgeted results and points out the areas where management action is more needed.

8. Cost audit also enables comparison among different units of the factory in order to find out the profitability of the different units.

9. Cost audit exercises moral influence on employees which keeps them efficient and alert.

10. Cost audit ensures that the cost accounts have been maintained in accordance with the principles of costing employed in the industry concerned.

11. It will help in management in taking important decisions because prompt, accurate and reliable information is made available to management with help of cost audit.
12. Management by exception is possible since cost audit separates efficient from inefficient operations and fixes individual responsibility for in efficient.
13. Analysis of variances is facilitated with cost audit because comparison of actually with standard production and sales is made.
14. Cost audit is very usefully in public undertaking because it pin points the inefficiency of the employees.

B. To the Shareholders

1. Cost audit ensures that proper records are maintained as to purchases, utilization of materials and expenses incurred on various items i.e wages and overheads etc. It also makes sure that the industrial unit has been working efficiently and economically.

2. The cost audit enables shareholders to determine whether or not they are getting a fair return on their investments. It reflects managerial efficiency or inefficiency.

3. Cost audit ensures a true picture of company's state of affairs. It reveals whether the resources like plant and machinery are being properly utilized or not.

C. To the Society

1. Cost audit tells the true cost of production. From this the consumer may know whether the market price of the article is fair or not. The consumer is saved from the exploitation.

2. Cost audit improves the efficiency of industrial units and thereby assists in economic progress of the nation.

3. Since price increase by the industry is not allowed without justification as to increase in cost of production, consumers can maintain their standard of living.

D. To the Government

1. Cost audit assists the 'Tariff Board' in deciding whether tariff protection should be extended to a particular industry or not.

2. Cost audit helps to ascertain whether any particular industry should be given any subsidy in order to develop that industry.

3. Cost audit provides reliable data to the government for fixing up the setting prices of the various commodities.

4. Cost audit helps the government to take necessary measures to improve the efficiency of sick industrial units.

5. Cost audit can reveal the fraudulent intentions of the management.

6. Cost statements may be helpful to authorities in imposing tax or duty at the cost of finished products.

7. Cost audit facilitates settlement of trade disputes of the companies.
8. It help full in ascertaining cost claims submitted to the government under the cost plan contract

To the Auditors

1. Cost audit assist the financial auditor because he can safely relay on many important costing data such as cost of closing stock of raw material, WIP, and finished goods.

Scope of Cost Audit

Section 227(2) of the Companies Act, 1956, requires the auditor of a company to state whether the Accounts in his opinion give a true and fair view of the state of the company's affairs in the case of the balance sheet and of the profit or loss for its financial year in the case of the profit and loss account. Therefore, statutory financial audit of a company conducted by the Chartered Accountant is an essential annual feature of all the companies registered under the provisions of Companies Act, 1956. The Board of Directors of every company has a statutory obligation to place its audited annual accounts viz. Profit and Loss Account and Balance Sheet before the shareholders in the Annual General Meeting, duly certified by a Chartered Accountant appointed as an 'Auditor' under the provisions of Section 224 of the Act. However, there is no corresponding statutory provision for compulsory annual audit of cost accounts of a company covered under Section 209(1)(d) of the Companies Act or under relevant Cost Accounting Records Rules.

One of the pre-requisites of cost audit is the maintenance of cost accounting records by the company. Section 209(1)(d) makes it obligatory for a company pertaining to any class of companies engaged in production, processing, manufacturing or mining to maintain such particulars relating to utilization of material or labour or to other items of cost as may be prescribed, if such class of companies is required by the Central Government to include such particulars in the books of accounts. The rules provide that only those companies, which are covered under Section 209(1)(d) of the Companies Act and a specific Cost Audit Order has been issued with reference to a specified product by the Cost Audit Branch of Ministry of Corporate Affairs are required to get their cost accounts audited with respect to that specific product. Moreover, Cost Audit Report is not placed before the shareholders during the Annual General Meeting.

The Central Government prescribes the separate cost accounting records for each class of companies i.e. companies manufacturing a particular class of product or activity like Cement, Steel, Chemicals and Electricity etc. and these are called the Cost Accounting Records Rules for that specific c industry or class of companies. When cost accounting records/formats are prescribed, they apply to those companies engaged in the manufacture of a particular product or activity. In the case of companies engaged in production or processing of other products or activities also in addition to production, processing or manufacture of the specified product, the records will have to be maintained only for the manufacture of particular product for which rules are issued and not necessary for other products. A company manufacturing bulk drugs, formulation and watches need not necessarily maintain cost accounting records in respect of watch making activity if no statutory rules are prescribed for watch making activity. The detailed provisions relating to the manner of prescription of cost accounting records, selection of the product, the contents of the rules and the list of products/industries covered by the statutory rules under Section 209(1)(d) of the Companies Act have also been explained in Study Notes 2 and 3. Thus Cost Audit u/s 233B does not embrace a particular activity of the company unless a separate cost accounting record rule is already notified for that particular activity under Section 209(1)(d) detailing the nature of cost accounting records to be maintained.

The legal provisions relating to statutory cost audit are applicable only to companies registered under the provisions of Companies Act, 1956. Therefore, cost audit is not applicable to other enterprises like partnership, cooperative societies, etc. The Cost Audit is conducted by a Cost Accountant in practice within the meaning of the Cost and Works Accountants Act, 1959. The cost auditor is appointed by the Board of Directors of the company with the previous approval of the Central Government. The report of cost auditor is to rendered to the Central Government with a copy to the Company.

Meaning of Partial Audit

An audit which is conducted considering the particular area of accounting is known as partial audit. Under partial audit, audit of whole account is not conducted. Audit of particular area where the owner thinks essential to conduct audit will be conducted. Generally, transaction of business is related to cash, debtor, creditor, stock etc. A business may conduct an audit of any of these transactions.

An auditor should conduct audit of that transaction as per the scope determined by the agreement. Method of conducting such audit is similar to other audit but an auditor should sign the report clearing stating the 'partial audit'. If it is not done so, an auditor will be liable for the loss which is caused due to using the report as complete audit.

Objectives of Partial Audit

1. To know whether the capital is fully mobilized or not.
2. To clarify the doubts where the owner has suspected.

3. To conduct final audit in less time and in less expenses because particular area of account is checked in detail.

Advantages of Partial Audit

1. Partial audit conducts the audit of suspected area; so, work of audit remains less expensive.
2. Partial audit helps to detect and improve the frauds and errors quickly because audit of suspected area is conducted.
3. Partial audit provides suggestions after checking books of accounts of particular area which helps to increase the efficiency of staffs.

Disadvantages of Partial Audit

1. An organization and auditor cannot present as proof to the report of partial audit because it is not legal audit.
2. Partial audit is made only for control purpose but it does not prove true and fair of financial position.
3. Partial audit is not statutory audit. So, final audit is compulsory which misuse of time, labor and cost.

Types of cost audit

- ✓ Cost audit to assist management. The main object of this type of cost audit is to make available accurate, relevant and prompt information to management to assist it in taking important managerial decision. In this type of audit, a cost auditor suggests ways to reduce the cost of production and to make important in the cost accounting plan.
- ✓ Cost audit on behalf of the government. The government may appoint a cost auditor to conduct cost audit where it is necessary….
- ✓ To do so in the opinion of the government under section 233-B of the companies act 1956.
- ✓ To ascertain correct cost of certain units when government is approach for protection or financial help.
- ✓ To ascertain correct cost of the contract given to private firms under "cost plus" basis.
- ✓ To fix a reasonable prices of certain items of production so as to prevent undue profiteering

3. Cost audit on behalf of a customer. Sometimes, cost audit may be conducted on behalf of the customer when he agrees to pay price for a certain product on "cost plus" basis.
4. Cost audit on behalf of trade association.
    - ✓ To ascertain comparative profitability of it's a members:
    - ✓ To determine minimum price to avoid cut throat competition among its members:
    - ✓ To maintain prices at a certain level so as to prevent undue profiteering.
5. Cost audit on behalf of tribunals. Sometimes, labor tribunals may direct the audit of cost account to settle trade disputes for more wages, bonuses, share in profit.
6. Cost audit under statute. The central government may, under section 233-B of the companies act, 1956 order that certain classes of companies which are required to maintain proper records regarding materials consumed, labor and other expenses under section 209 are required to get their cost accountants audited.

Financial Audit V/S Cost Audit

	Financial Audit	Cost Audit
Statutory requirement	Compulsory in the case of all Joint stock Companies	Not compulsory to all companies. However, Sec 233-B of the Companies Act, 1956, has made cost audit compulsory in certain specified companies to be notified by the Central Govt from time to time.
Objective	It serves the objective of securing the creativeness of accounts through vouching and verification to detect the errors and frauds	It lays stress on propriety of expenditure and efficiency of performance. It is an audit of efficiency and of minute details of expenditure.
Scope	It covers the operations of the entire organization including branches of the company	It emphasizes mainly on operations relating to product under reference.
Time Limit	Must complete within 90 days from the end of FY	Must complete within 180 days from the end of FY
Qualification of Auditors	Must obtain CA by ICAI	Must obtain ICWA by ICWAI
Appointment of auditors	Appointed by the members of Company by ordinary resolution in AGM	Appointed by Board of directors with the prior approval of the Company Law Board, GOI
Submission of Audit report	Submitted to Shareholders and read , discussed in the AGM	Submit in triplicate to the Company Law Board with a copy to Company.

Functions of a cost auditor.

i. Examine the Inventory regarding its size, provisioning, Order size, storage cost, lead time, receipt and issue system, procedure, length of time taken need of actual, document maintenance, etc.,
ii. Verification of Opening and closing of stock verification
iii. Verification of Stores issue procedure
iv. Verification of Work in progress
v. Verification of Labour issues
vi. Verification of Capacity utilization
vii. Verification of overheads

Management audit

Management audit is an emerging concept of auditing. It has been originated from America. Management audit is an act of evaluation of all the activities of all the departments with a view to provide appropriate suggestions to the management to help their work. In other words, management auditing is a future oriented task which evaluates timely in all the levels of management like production management, sales management etc. The main objective of management audit is to improve the profit earning capacity, work of management, objectives of program, social objectives and human resource development so that organizational goal can be easily attained. It refers to the existence of control system, compliance of rules and regulations, process of managerial decisions etc.

Management Audit is the evaluation of the performance of management of an enterprise. It is a systematic approach by which various plans; policies and methods of operations etc., of the management are reviewed and appraised. The purpose of management audit may be to find out whether or not there has been optimum utilisation of human and physical facilities and whether the existing systems are adequate and effective to management for decision making.

Objectives of Management audit

i. To identify the overall objectives of a business enterprise and to see that these objectives are being fulfilled in actual practice.
ii. To ensure optimum utilization of human resources and available physical facilities
iii. To see that management is efficient at levels of operations
iv. Top suggest improved and better methods of managerial operations.
v. To point out weak spots in the organization structure and in internal control system and suggesting possible improvements
vi. To see that enterprise is successful in adopting itself to technological changes
vii. To anticipate problem and suggest remedies to solve them in time.
viii. To see that return on capital employed is satisfactory and to help improve profitability.

Functions of Management Audit

Management audit is a difficult and complex task. It performs the following functions:

1. Management audit identifies the objectives of an organization if such objectives are not set up.

2. Management audit allocates the overall objectives of an organization in small parts.

3. Management audit reviews the structure of organization and asset of the organization and decides whether goals can be obtained or not.

4. Management audit examines all the scope of work and liability centers.

5. Management audit provides valuable suggestions to the management after the evaluation of all above facts.

Scope and Process of Management Audit:

The scope of Management Audit can be as broad as the management process itself.

In this context, Camp-field outlines a few scopes as below:

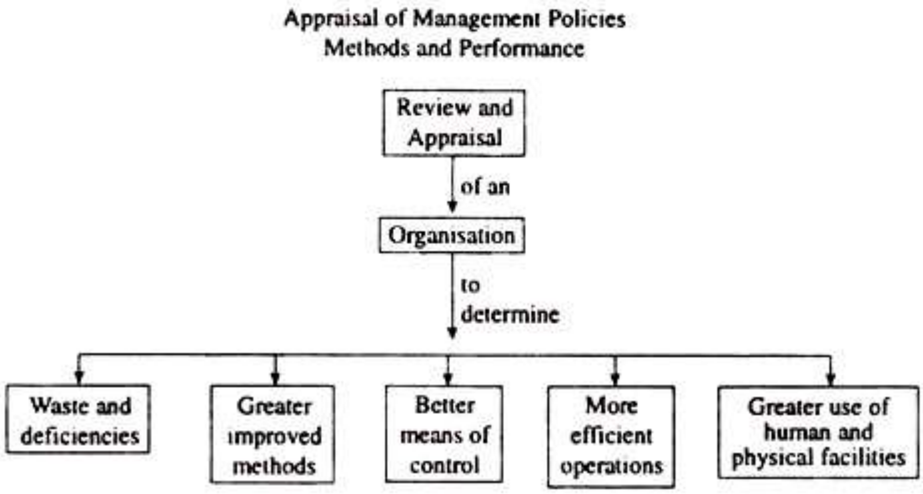
1. Studying the prescribed organisation—reviewing formal organisation structure, personal inter-relationships, policies, procedures, information systems and flows, and decision centre in order to determine what management has established as optimum arrangements for running an entity.

2. Evaluating the 'live-entity'—determining such problems as what operating people are really trying to accomplish, the schedules and routines they have established to attain objectives, and a measure of the results achieved in the light of predetermined goals and standards of performance.

3. Searching for Profit inhibitors—uncovering poor organisational structuring and responsibility assignment, breakdowns in operations, programming and work flow, inadequate and ineffective communications, evaluation and measurement; and disclosing results that fall significantly below established standards."

Since the concept of Management Audit requires the appraisal and assessment of total organisation or management processes and examines in depth the functioning of the system and its performance, its scope is synonymous with the appraisal areas identified by the American Institute of Management.

The scope of management audit can, therefore, be expressed by a chart below:



Reporting-Introduction

The purpose of reporting is to provide the information needed by the concerned party. The value of information is determined by how the information meets the needs of the users. This information creates an atmosphere for internal decision makers. The communication of the information between two or more parties through reports is known as reporting. Report is a statement containing facts and if they contain accounting information and data they are called accounting reports. So, report may be known as process of providing accounting information to those who needs to make decisions. Report may be for the past, present and for the future developments.

Concept of Management Reporting

Reporting can be defined as communication of statements with related information between the two parties. The process of providing information to the management is known as management reporting. These reports are provided to the various levels of management on regular basis to keep the management side by side about the effectiveness of their respective responsibility. Reporting is an important function of the management accountant as the efficient and smooth working of the business depends upon the good Reporting. The effectiveness of reporting to management to a large extent depends upon the form and timing of its presentation. The process of reporting to management is concerned with proper selection of financial and operating data, arranging information in a proper form, analysing and interpreting the data and then reporting it to the management through an appropriate method.

Objectives of Reporting (Purpose of Reporting)

Main objectives of reporting can be divided under the following heads:

a) **Providing accounting information:** Accounting reports consist of financial statistics. Management may not analyse all significant facts regarding its business operations especially in case of large scale production where the business operations are more complex in nature. Accounting reports help to get full information about its entire operative activity of the firm. Thus important objective of the reporting is to provide accounting information to operating and top level management in accurate form in understandable brief manner.
b) **To take right decision:** To help the management in taking the right decisions with suitable statements provided by the management accountant.
c) **Acceptability of the decision by all:** Reporting leads to motivate people, increases efficiency and boosting the morale of the people engaged in the various aspects of the work of the enterprise.
d) **Maximizing the profits:** To achieve this ultimate goal of any business reporting at the right time, at right place to the right person in right manner becomes an essential feature.

e) **For better control:** Abnormal events can be checked in time by obtaining the necessary information in respect of each operating activity. Control through reports become effective as compared to personal investigations.

Reporting Needs at Different Managerial Levels

Reporting is the lifeline of the organization. It helps in planning and control and works as a media of communication and stimulates corrective action. Accounting system becomes useless, if the business has no system of reporting because all decisions are normally based on reporting system.

Need of reporting differs at different management as well as user community levels.
There are three levels of management and the reports can be classified according to the needs as follows:

1) Top-Level Management Reports
2) Middle Level Management Reports
3) Lower Level Management Reports

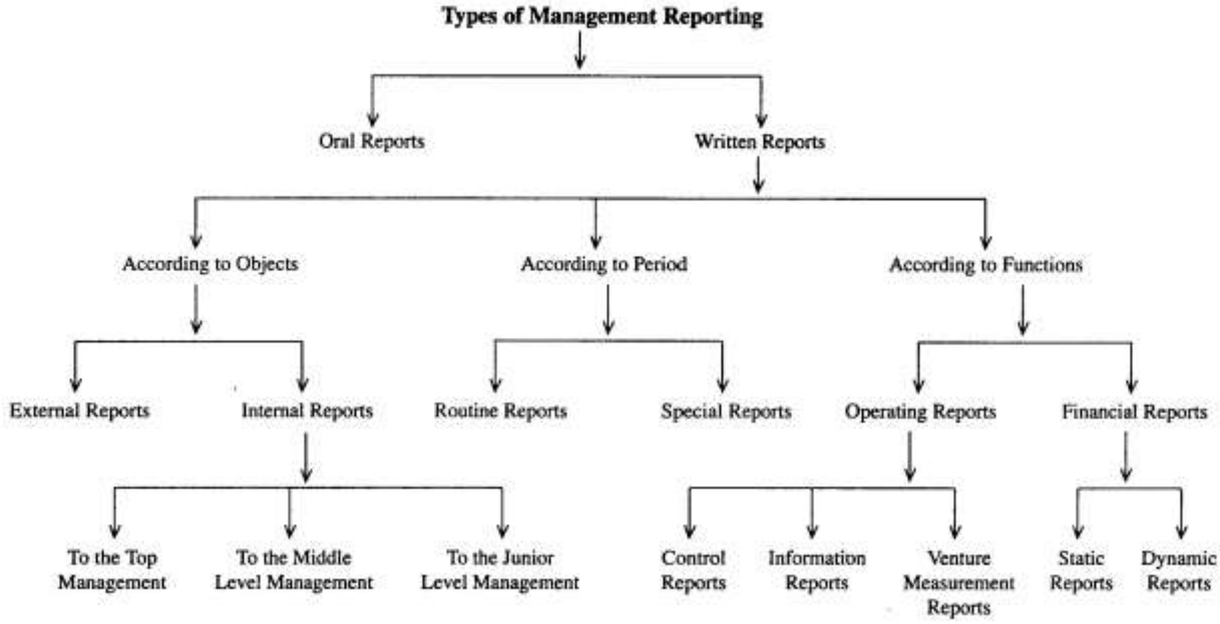
Requisites of Good Reporting System

The following are the requisites of a good management reporting system:

(1) **Proper Form**: A good report should have a comprehensive form with suggestive title, heading, sub heading and number of paragraphs as and where necessary for easy and quick reference.
(2) **Contents**: Simplicity is one of the requisites of reporting in relation to the contents of a report. Further the contents should follow a logical sequence. Wherever necessary the contents should be represented in the form of visual aids such as charts and diagrams etc.
(3) **Promptness**: It means that the system should ensure the preparation and submission of report at the proper time. It facilitates business executives to make suitable decisions based on quick reports without delay.
(4) **Accuracy:** Information conveyed should be accurate. This means that the person responsible for reporting should have sufficient care in preparing the report as correctly as possible within the parameters of possible accuracy in this regard.
(5) **Comparability:** In order to ensure that the furnished information is useful, it is essential that reports are also meant for comparison. The report should provide information about both the actual and the budgeted performance of the budget period. So that meaningful comparison can be made to find out the deviations and to initiate appropriate action.
(6) **Consistency**: In order to make a meaningful and useful comparison, uniform accounting principles and procedures should be followed on consistent basis over a period of time for collection, classification and presentation of accounting information.
(7) **Relevancy**: The report should be presented with relevant data to disclose the fact in unambiguous terms. Because, inclusion of both the relevant and the irrelevant data in the management reports may result in faulty decisions. Therefore, the contents expressed therein should reveal the reporter's greater consciousness of expression with reference to length and time in particular.
(8) **Simplicity**: The report should be as far as possible in simple form. In other words, the report should avoid technical jargons, duplication of work and presented in a simple style.
(9) **Flexibility**: The system should be capable of being adjusted according to the requirement of the users.
(10) **Cost-Benefit Analysis**: Cost-Benefit Analysis should be made and the cost of reporting should commensurate with the expenditure involved.
(11**) Principle of Exception:** Since the time and effort of managerial personnel are precious, the principle of management by exception has become the rule of the day instead of exception. It is necessary therefore to draw the attention of management, through reports, only towards exceptional matters.
(12) **Controllability**: It is necessary that every report should be addressed to a responsibility centre and analysed the factors into controllable and uncontrollable separately. So that the head of the responsibility centre can be held responsible only for controllable variance but not for variances which are beyond his control.

Classification of Report

Basically, there are two ways to report to the management. They are (1) Oral Report and (2) Written Report. The Written Reports may be classified into number of ways. The following are the important types:



I. According to Object or Purposes

(A) External Reports: These reports prepared for persons outside the business such as Government. shareholders. bankers. investors and financial institutions etc. External Reports usually represent published annual reports. Annual Reports of Trading. Profit and Loss Accounts and Balance Sheet of the Indian Companies are to be prepared in terms of Schedule VI of the Indian Companies Act of 1956.

(B) Internal Reports : Internal Reports are those which are prepared for internal uses of different Level of management. It is also called as Management Reports. These reports are not meant for disclosure to those who are outsiders to the business. They do not have to comply with any statutory requirements.
From the managerial point of view the reports can be classified into the following categories :
(1) Report Meant for the Top Level of Management
(2) Report Meant for the Middle Level of Management
(3) Report Meant for the Junior Level of Management

1) **Top Management Reports**

At this level reports are concerned with the following matters:
- For determining the aims of the enterprise;
- For formulation of policies and plans;
- For delegation of responsibility in successful manner to executives for the best utilization of resources;
- For formulating special significant plans.

It can be assumed that top brass of the business only needs reports for cost and operational control. The report submitted to the level should be brief or we can call it a summarized statement, which provides an overall view on the subject. Previously these reports used to be submitted within the time framework. The time framework may be monthly, quarterly or yearly. With the use of information technology and the real time accounting, the whole time framework has been changed and now these can be made available online.

Reports to top level management consist of the following:
a) Reports to the Board of Directors
b) Reports to the Chief Finance Officer
c) Reports to the Chief Production officer, and
d) Reports to the Chief Executive Marketing and Sales.

a) **Reports to the Board of Directors & CEO :** Generally, following reports are to be submitted to the Board of Directors and the Chief Executive Officer (C.E.O.):

i) Different budgets,
ii) Machine utilization statement
iii) Work force utilization statement
iv) Cost analysis statement
v) Fund flow statement
vi) Cash flow statement, and
vii) Balance sheet and income statement

b) **Reports to the Chief Finance Officer :** Following reports are to be submitted to the Chief Finance Officer (C.F.O.) :
i) Cash flow statement,
ii) Funds flow statement,
iii) Abstract of receipts and payments and
iv) Report regarding any special problem such as make or buy, replacement of old assets or any other.

c) **Reports to the Chief Production Officer:** Following reports are to be submitted to the Chief Production Officer (C.P.O.):
i) Cost analysis statement
ii) Machine utilization report
iii) Work force utilization statement
iv) Materials statement,
v) Production statement showing budgeted and actual with variance and
vi) Overheads cost statement

d) **Report to the Chief Executive Marketing and Sales:** Following reports are to be submitted to the Chief Executive Marketing and Sales:
i) Sales summary
ii) Reports on credit collection
iii) Reports of orders received and executed and outstanding orders
iv) Report on stock of finished goods

2) Middle Level Management Reports

The middle level management consists of the heads of various departments. The reports at this level should show the efficiency and cost data relating to different departments. At this level execution of plans formulated by the top management is worked out and all the managers in each department are concerned with this. It is also the function of middle level management to coordinate different activities of different departments. The reports at middle level management consists of the following:

a) **Report to the General Manager :** The following Reports are to be submitted to the General Manager :
i) Administration budget,
ii) Cash and capital budget,
iii) Salaries statement of staff and
iv) Research and development budget

b) **Report to the Finance Manager :** The reports to be submitted to the Finance Manager are:
i) Funds flow statement
ii) Cash flow statement
iii) Cash and bank reports
iv) Debtor's collection period reports
v) Average payment period reports

c) **Reports to the Purchase Manager :** The following reports are to be submitted to the Purchase Manager:
i) Stock level of raw material,
ii) Use of raw material,

iii) Raw material budget and actual purchases and
iv) Budgeted cost and actual cost of purchases

d) **Reports to the Works Manager:** The reports submitted to the Works Manager are:

i) Production cost report
ii) Raw material budget and actual consumption
iii) Production budget and actual production
iv) Idle time report
v) Idle capacity report

e) **Reports to the Sales and Marketing Managers:** The following reports are to be submitted to the Sales and Marketing Manager:

i) Report of budgeted and actual sales,
ii) Report of orders booked and executed,
iii) Statement of sales,
iv) Finished goods stock position and
v) Position of collections and debtors.

With modernization and adoption of computers in the business house, the reporting period has been reduced tremendously and the data are ready at hand and these can be used to prepare reports instantly. Middle level management is connected on line with the computers within the organization, so preparation of reports has become easy.

3) **Lower Level Management Reports**

At this level foremen and supervisors are concerned at the floor and they prepare their reports physically without any expert opinion. They are concerned with the daily work and they infuse a certain amount of Competitive spirit among the workers by comparing the output per man per hour in a similar job.

These reports include the following:

i) Workers efficiency report,
ii) Daily production report,
iii) Workers utilization report
iv) Scrap report
v) Over-time report
vi) Material spoilage report
vii) Accident report etc.

II. According to Period

a) **Special Reports:** These reports play a vital part in decision-making. They are prepared for specific reasons. While preparing this type of report the problem under study should be clearly be defined and understood and effect of cost and income should be considered. Comparison of cost of study and estimation of cost and income relating to the problem should also be considered. These reports can be prepared for any of the problems relating to:

i) market analysis, ii) Make or buy decisions iii) Problems of raw material iv) Technological changes
v) labour problems vi) Cost reduction schemes

b) **Routine Reports:** These are only control reports and they are required only when a control system exists. These are prepared daily as per scheduled time regarding activities. Production operation reports, cost reports, research and development reports, various budget reports, utilization of man, machine and material repor ts, report regarding customer default, sales and distribution report, administration reports, income statement and balance sheet and cash flow statement are included in this classification.

III According to Functions

There are two types of reports according to functions. They are : i) Operating Reports and ii) Financial Reports.

a) **Operating Reports:** These reports convey the information regarding the operations of the business at different functional levels. These reports are used to review and control the total production and to improve the interdepartmental efficiency. Operating reports can further be classified as information reports and the control reports.

i) **Information Reports:** The reports prepared for this purpose should be simple and clear in respect of various operating activities. These reports are of three types, viz., trend reports, analytical reports and activity report. In trend reports, comparative information is provided over a period regarding the direction or trend of different activities. Analytical reports are based on the horizontal comparison of results. This provides information in an analytical manner about comparison of different activities for a particular period. When reports are prepared for any particular activity of the business then they are known as activity reports. Segment reports are also information reports.

ii) **Control Reports :** These reports are prepared to help the managers in controlling the operations of the business. Various responsibility centres are established in every business to have an effective control.

To know the performance of each responsibility centre reports are prepared for them. First important aspect regarding the performance of the centre manager and the other is concerned with the economic performance of the centre towards the goal or the business, are the main features of these reports. These reports can be current control reports or they can be summary control reports. Summary control reports can be master summary control reports or these can be subsidiary summary control reports.

b) **Financial Reports :** Financial reports differ from control or information reports. They are necessary to know the success or failure of the management's responsibility to shareholders through the accounting. These reports can be of two types *viz*., dynamic financial reports and static financial reports. Dynamic financial reports show the changes took place during the year in the financial position of the business. These reports include report of financial change, financial control reports and effective use of funds reports. Static financial reports provide the information regarding the position of assets and liabilities. They include balance sheet and certain additional statements for individual items of the balance sheet.

Modes of Reporting

There are three modes of reporting:, 1) Written 2) Graphic, and 3) Oral. These reports are further divided as follows :

Written	Graphic	Oral
1. Financial Statements 2. Tabulated Information Conferences and individual talks 3. Accounting Ratios	1) Charts 2) Diagrams & pictures 3) graphs	1) Group meetings 2) Conferences and Individual talks

Segment reporting

A segment of business defined as "Component of an entity whose activities represent a separate major line of business or class of customer. A segment may be in the form of a subsidiary or division or a department, and in some cases a joint venture or other non-subsidiary investee, provided that its assets, results of operations and activities can be clearly distinguished, physically and operationally and for financial reporting purposes from the other assets, results of operations and activities of the entity."

Institute of Chartered Accountants of India has emphasized on segment reporting reason being, it can be helpful to the users of financial statements in many ways**:**

(i) Users of financial statements can better understand the performance of an enterprise.
(ii) Users can better assess the risks and return of an enterprise.
(iii) Users can make more informed judgment about the enterprise judgment about the enterprise as a whole.
(iv) Users can benefit from an enhanced degree of comparability with other enterprises.

User Groups of Segment Reporting

1. Investors:
Segment reporting provides investor's information about profitability risk and growth of various segments of enterprises operations. Investors will be in better position to assess accurately a firm's future earnings. Investor's uncertainty about company's prospects will thus be reduced with the help of segment reporting.
2. Employees:
Employees and trade unions are also interested in the performance and prospects of the enterprise from the stand point of wage negotiations and job security. Segment reporting helps them as it helps investors.
3. Management:
Segment reporting is also helpful to the management while taking various important managerial decisions. Management while taking policy decisions may need for information on segmental performance. Lack of information on segmental performance may lead to misunderstanding between Management and workers.
4. Government Agencies:
Government agencies at national and international level in the case of multinational companies, are becoming more concerned by the activities of large companies and the balance; of payments. Segment disclosures by the geographical location seem likely to promote a better understanding of corporate strategy and its impact.
5. Consumers:
The Interests of consumers and the General public may also be promoted by segmental disclosures in the sense that social responsibility in terms of the removal of price discrimination could be encouraged by segment disclosures regarding profits.

Cost reduction and cost control

Cost Reduction is a process, aims at lowering the unit cost of a product manufactured or service rendered without affecting its quality by using new and improved methods and techniques. It ascertains substitute ways to reduce the cost of a unit. It ensures savings in per unit cost and maximization of profits of the organization.

Cost Reduction aims at cutting off the unnecessary expenses which occur during the production, storing, selling and distribution of the product. To identify cost reduction, the following are the major elements:

- Savings in per unit cost.
- No compromise with the quality of the product.
- Savings are non-volatile in nature.

Tools of cost reduction are Quality operation and research, Improvement in product design, Job evaluation & merit rating, variety reduction etc.

Cost reduction is the maximization of profits by reducing costs through economies and savings in cost of manufacture, administration, selling and distribution.

The CIMA, London defines: "cost reduction is to be understood as the achievement of <u>real</u> and <u>permanent reduction</u> in the unit cost of goods manufactured or services rendered, without impairing their suitability for the use intended or diminution in the <u>quality</u> of the product."

The major techniques used in cost control are standard costing and budgetary control. It is a continuous process as it helps in analyzing the causes for variances which control wastage of material, any embezzlement and so on.

Characteristics of Cost reduction

- Through increased productivity, improved design, better methods or new design etc.,
- Permanent in nature

- Should not impair the quality and suitability of essential characteristics of the product or services.

Fields covered by Cost Reduction

1. Product Design:-

- Cheaper substitutes, cutting material holding cost.
- Reduced time of operation.
- Standardization of processes

2. organization:-

- Definition of each function & responsibility.
- Proper assignment of tasks & responsibility.
- Encouragement of employees for cost reduction suggestions

3.Factory Layout & Equipment:-

- Elimination of wastage of men, materials.
- Maximum utilization of facilities.
- Replacement of out dated machinery
- Implementing new technology.

4. Administration:-

- Systematic supervision of the use of machinery.
- Possibility of reduction in files & filing space.
- Expenditure on printing, postage & telephone.

5) Marketing:-

- Various activities which can be brought under cost control-
- Market research, advertisement, packing, warehousing, after sales service.
- Categorization of customers-
- A- account for 70% of value of purchases & 10% of quantity.
- B- account for 25% of sales value & 20% of dispatches.
- C- account for 5% of purchase value & 70% of dispatches.

6) Personnel management:-

- Cost reduction programme should explore-
- Reduction in labor cost by improving labor relations, welfare measures & better working conditions.
- Evaluation of existing incentive schemes.

7) Material control: -

Aspects to be considered are-

1. Economical purchase of materials.

2. Keeping low inventory.
3. Effective check on goods received.
4. Control over material storage & issues.

List of tools and techniques of cost reduction.

i. Standard Costing
ii. Budgetary control
iii. Inventory control
iv. Production planning and control
v. Standardization and simplification
vi. Operational research and statistical techniques
vii. Value analysis
viii. Automation
ix. Design improvement
x. Market research
xi. Job evaluation and merit rating
xii. Work study
xiii. Organization and methods study
xiv. Quality control

Cost Reduction- Advantages

- Increases profit which would be distributed to shareholders, employees & utilized for expansion.
- Will provide more money for labor welfare schemes-improve labor mgmt relationship.
- Decrease in costs- Increased demand for products-increased revenue.
- Low cost- killing competitors.
- High profit- more revenue to the Govt.
- Reduction in cost- increase in exports.
- Social benefits- cheaper prices, increased employment opportunities & improvement in standard of living.

Cost Reduction- Disadvantages

1. Quality may be sacrificed for reducing cost.
2. Resistance from employees.
3. Conflict between individual objective & organizational objective. It is possible that a particular dept may follow activities which may reduce the cost of his/her dept but may lead to increase the cost for the organization as a whole.

FEATURES OF COST CONTROL

- COST ACCOUNTING- it is feasible when an organization has effective cost accounting system to provide relevant information
- COST PLANNING- cost control aims at achieving the cost targets. so, an organization should have proper planning system. targets should be set after taking into considerations all relevant factors.
- COST REPORTING- it must be inbuilt in the organization to have a continuous basis of information about actual and predetermined costs of different products to concerned level of management.
- CORRECTIVE ACTIONS- on observing the variance, the management must identify the causes of variances and take appropriate remedial measures.

Distinguish between cost control and cost reduction

Cost control	Cost reduction
It is the achievement of predetermined targets of costs	It is the achievement of the real and permanent reduction in costs
It tends to assume a static state of affairs and that standards once set are not challenged	It assumes the existence of concealed potential savings in the standards or pre-determined costs set for cost control and that these standards are always subject to challenge.

It is concerned with predetermining costs, comparing it with actual costs, analyzing the variances and taking corrective action	It is not concerned with maintenance of performance according to predetermined targets. It is rather concerned with finding out new product designs, methods etc.,
It is a preventive function as it aims to prevent the costs from exceeding the predetermined targets	Cost reduction is a corrective function because it challenges the predetermined targets and weeks to improve performance by correcting the targets
It is a part of cost accounting function	It may be achieved even when no cost accounting system is in operation
Cost control lacks dynamic approach to cost improvement	Cost reduction is a more dynamic approach to cost improvement and elimination of waste.

State the merits of cost reduction and cost control.

i. More dividend to shareholders
ii. More money for labour welfare schemes and thus improve men-management relationship
iii. Products available to consumers at cheaper rates
iv. More revenue to Govt by way of taxation
v. Reduction in export price and thus increase the total exports
vi. High productivity

Target Costing

Target Cost: A *target cost* is the allowable amount of cost that can be incurred on a product and still earn the required profit from that product. It is a market driven cost that is computed before a product is produced. A budgeted cost is a predetermined cost after a product is in production. A budget is an operational definition of an allowable cost broken by items and by periods.

Nearly 80% of the costs of many products are committed at the design stage. Therefore, the best opportunity to reduce costs is during design and not after a product is being manufactured.

Target costing occurs within the product development cycle. This means it starts when a product is in its concept stages and ends when a product has been released for manufacturing.

Target Costing v/s Cost plus

TARGET COSTING	*COST-PLUS*
Competitive market considerations drive cost planning.	**Market considerations not part of cost planning.**
Prices determine costs.	**Costs determine price.**
Design is key to cost reduction.	**Waste and inefficiency is focus of cost reduction efforts.**
Customer input guides cost reduction.	**Cost reduction is not customer driven.**
Uses cross-functional teams to manage costs.	**Cost accountants are responsible for cost reduction.**
Supplier involved early.	**Suppliers involved after product designed.**
Minimizes cost of ownership to customer	**Minimizes initial price paid by customer.**
Involves the value chain in cost planning.	**Little or no involvement of value chain in cost planning.**

Balanced scorecard

The balanced scorecard is a strategic planning and management system that is used extensively in business and industry, government, and non profit organizations worldwide to align business activities to the vision and strategy of the organization, improve internal and external communications, and monitor organization performance against strategic goals.

Characteristics of Good Balanced Scorecards:

1. Balanced scorecards should highlight a company's strategy by focusing on cause-and-effect relationship. Assume, Hindustan Unilever Ltd. aims to be a low-cost manufacturer and accelerate growth. The balanced scorecards should pinpoint specific objectives and measures in 'learning and growth perspective' which could improve internal business processes. These, in turn, would result into greater customer satisfaction, larger market share, higher operating income and shareholder wealth.
2. Balanced scorecards should help in communicating the strategy formulated to all members of an organisation by translating the strategy into a coherent and linked set of understandable and measurable operational targets. Subsequently, managers and employees take actions, based on scorecard, to achieve the firm's strategy. To facilitate decisions and actions in accordance with scorecards, it is preferable to develop scorecards at the division and department levels.
3. In profit-seeking companies, the balanced scorecard gives strong emphasis on financial objectives and measures. Sometimes managers give too much importance to innovation, quality and customer satisfaction though they may not produce tangible benefits. A good balanced scorecard considers non-financial measures as a part of a strategy or programme to achieve and improve future financial performance. When financial and non-financial performance measures are properly linked in balanced scorecards, many non-financial measures serve as leading indicators of future financial performance.
4. The balanced scorecard limits the number of measures used by identifying only the most critical ones. Avoiding a proliferation of measures focuses management's attention on those that are key to the implementation of strategy.
5. The scorecard highlights suboptimal tradeoffs that managers may make when they fail to consider operational and financial measures together. For example, a company for which innovation is key, could achieve superior short-run financial performance by reducing spending on R&D. A good balanced scorecard would signal that the short-run financial performance may have been achieved by taking actions that hurt future financial performance because a leading indicator of that performance, R&D spending and R&D output, has declined.

Objectives of Balanced score card

- To satisfy the needs of customers.
- To know about how efficient and effective the unit is at using its resources.
- To asses performing internal processes and in employee competencies.
- The *Innovation & Learning Perspective*
- To emphasizes continuous improvement and the creation of value.

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