SCHOOL OF STUDIES IN COMMERCE

VIKRAM UNIVERSITY, UJJAIN (M.P.)

CLASS: B.B.A. (HONS.) 4TH SEM.

SUBJECT: CORPORATE AUDITING

TITLE OF LECTURE: COST AUDIT

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TOPICS

INTRODUCTION:

Cost Audit is the verification of the cost accounts and of the adherence to the cost accounting plan. That is, it not only involves the examination of cost accounts but also the fact that plan prepared in this connection has been duly executed. The Indian Companies Act has made provisions to perform cost audit to certain categories of companies engaged in the production processing, manufacturing and mining activities under section 209 and 233 B. It has however not been made compulsory for all the companies. The duties and powers of the Auditor are set out under section 227 of the said Act. Cost Auditor will not submit his report to the members of the company but will have to submit to the Company Law Board.

Cost audit is an examination of cost accounting records and verification of the facts to ascertain that the cost of the product under reference has been arrived at in accordance with principles of Cost Accounting and evaluation of adequacy of proper Cost Accounting Records and their maintenance. The cost audit is performed by an independent, professionally qualified Cost and Management Accountant or Chartered Accountant. Cost audit is carried out to evaluate cost performance of the entity for which Cost Accounting Records have been prescribed by the Securities and Exchange Commission of Pakistan (SECP). The Cost Auditor, therefore, carries out such tests and makes such inquiries which enable him to give a professional, independent, unprejudiced opinion on the cost performance of the entity, as reflected in the cost information provided in the schedules and annexure which are prepared by the entity in accordance with the cost accounting records maintained.

DEFINITION:

Cost Audit may be defined as 'the verification of cost records and accounts and a check on the adherence to the prescribed cost accounting procedures and the continuing relevance of such procedures."

ORIGIN OF COST AUDIT:

Methods and techniques of 'cost accounting' and audit of 'cost accounts' in India can be traced back to the year 1925, when large number of firms were given contracts by the Government of India on "cost plus" basis and the Government started verifying and investigating the cost structure of such firms.

Need for large scale industrialization immediately after the independence required lot of concessions and facilities to the entrepreneurs to establish industrial undertakings for production of common man's goods and essential services. Power, electricity and other inputs were provided at concessional rates. Liberal finances were provided by the banks and other financial institutions. Land was made available with all infrastructures. Transport facilities were also provided. However, there were only very few industrial groups and it was a suppliers market in almost all the areas. There were many bureaucratic hurdles in opening of new industries along with need for licenses and permits. Imports were mostly prohibitive due to scarce foreign exchange and very high rate of custom duties on imports. Therefore, consumers had very few choices and there were often complaints of excessive pricing, which encouraged smuggling and other malpractices like under-invoicing of imports to save custom duties or over-invoicing of exports to get higher export benefits.

The high prices were often justified on the basis of higher indigenous cost of production. Thus the government felt the need for price controls. The investigations of Dalmia-Jain group of companies further brought out the need for more effective audit. Thus "cost audit" gained recognition, both as an effective tool of cost-control in the hands of management to control costs and produce at competitive rates and also as a monitoring mechanism on behalf of other stakeholders including the consumer and the government. Cost Audit as a tool in the hands of Management enabled them to identify the inefficiencies. It acts as a review of the activities of the various cost centers of the company and points out the avoidable wastages and losses. The expertise and experience of the Cost Auditor helps them in knowing the exact areas having the scope for cost control and cost reduction through inter-firm comparison with standard industrial norms or peers in the industry. Government in turn ensured that the consumers are able to obtain their requirements at a fair price and do not pay for the inefficiency of manufacturers.

Consequently, the Companies Act, 1956 was amended in the year 1965 to incorporate the provisions relating to the maintenance of Cost Accounting Records and Cost Audit. These amendments were made on the basis of recommendations from the Vivian Bose Commission, Dutta Commission and the Shastri Committee.

RELEVANCE OF COST AUDIT:

In the initial years, Cost Audit was taken merely as a tool for 'price control mechanism' for consumer and infrastructure industries in India. The main objective of Cost Audit when statutorily introduced under the provisions of Companies Act, 1956 was to meet the Government requirements for regulating the price mechanism in core industries like Cement, Sugar, Textiles and consumer industries like Vanaspati, Formulations and Automobiles. The objective was to provide an authentic data to the Government to regulate the demand and supply in the country through a price control mechanism.

The liberalization of the economy and consequential globalization has further enhanced the need for authentic data. Therefore, the Cost Audit Report Rules have been amended from time to time to ensure that the comprehensive authentic information is available in the format required. The basic structure of the cost audit was laid down by the Cost Audit (Report) Rules, 1968 as prescribed under the relevant provisions of Companies Act, 1956. They were superceded by the Cost Audit (Report) Rules 1996, which were notified vide GSR 511(E) dated 5.1.1996. These Cost Audit (Report) Rules 1996 were also subsequently superceded by the Cost Audit Report Rules 2001, which were notified vide GSR 294(E) dated 27.12.2001

The necessity for and utility of properly documented information is more keenly felt now than ever before. In most parts of the world, free competition co-exists with appropriate rules and regulations to ensure free trade and absence of unfair practices. Therefore, in the present competitive scenario of globalization, the Cost Audit Reports have assumed greater importance and significance being the important source of reliable and authentic feedback to the government and its various departments and agencies. It may be clarified here that the Cost Audit Reports do not only contain merely the cost details, but are full of information related to all aspects of business organization which, if harnessed properly can provide a comprehensive analysis about the company, the industry and the economy as a whole. The

Cost Audit Report serves as an effective tool of information in the hands of directors on the Board ensuring good corporate governance.

In an environment of increasing foreign trade under WTO regime, dumping of products at very low prices have become a serious issue in the international trade. This dumping of products, often well below the cost price, if not properly countered may harm the indigenous industry. The cost records and the cost audit report play a very critical role in defense of local industry to substantiate their fair approach against any allegation of dumping. Similarly, when dumping allegations are levied against the exports by the Indian companies to any foreign company, the Cost Audit Reports can provide the valuable feedback to protect the interest of Indian companies.

The practice of selling below cost to ward off competition attracts the penal provisions of the Competition Law. This necessitates the availability of authentic cost details of the products marketed by industry and business houses to determine normative pricing or fair pricing. In fact, Competition Law to be effective against any anti-competition activity presupposes the availability of reliable and authentic cost data.

The transfer pricing issue has gained considerable momentum in international scenario. Cost Audit Report Rules 2001 include the provisions to take care of this aspect in right perspective. The fundamentals of transfer pricing are based on "arm's length" throughout the world. The cost details form the very basis of determining arm's length transfer pricing policy of any country. An audited cost records and the resultant Cost Audit Report becomes a major source of information, which can be effectively used by both Indirect and Direct Tax Authorities. The Central Excise Authorities also use Cost Audit Reports for verifying claim of the companies relating to ex-factory prices of the excisable goods especially in the case of inter-unit transfers.

The Tariff Commission relies on authenticity of the cost audit reports and makes use of these reports extensively in fixation of tariffs for the products covered under Cost Accounting Records Rules. The Cost Audit Reports are also made use of by the respective administrative Ministries of Government of India for fixation of administrative prices and working out subsidy, etc. Fertilizer Industry Coordination Committee (FICC) under the

Department of Fertilizers and the Directorate of Sugar under Ministry of Food use Cost Audit Reports extensively in taking decision with respect to the Industries under their purview. The Cost Audit Reports relating to Bulk Drugs and Formulations are used by the National Pharmaceutical Pricing Authority for fixation of prices of various drugs and formulations covered under the Drug Price Control Order, 1995.

FEATURES OF COST AUDIT:

The cost audit of the companies under the relevant provisions of the Companies Act, 1956 has the following features:

(i) Assessing compliance of the relevant cost accounting records rules as applicable to the product under review;

(ii) Study of the costing system to assess whether it is adequate for the cost ascertainment of the product under review;

(iii) Evaluation of the operating and other efficiencies of the organization under audit with special reference to the product under review; to ensure the submission of necessary details required under the Cost Audit Report Rules, 2001 as amended from time to time.

(iv) Submission of Cost Audit Report in the format prescribed.

Since cost audit is carried out under the various provisions of the Companies Act, 1956, a thorough and comprehensive knowledge of the Indian Companies Act including various rules prescribed there under and the circulars issued by the Ministry of Corporate Affairs is essential for conducting an effective Cost Audit.

PURPOSE OF COST AUDIT:

The purpose of Cost Audit is to examine whether the methods laid down for ascertaining costs and other decisions are being properly implemented and whether the cost accounting plan is being adhered to or not. The purposes can, therefore, be classified under two heads, namely:

(1) Protective

(2) Constructive

(1) **Protective Purpose**: Under protective purpose, it aims to examine that there is no undue wastage or losses and costing system brings out the correct and realistic cost of production or processing.

(2) **Constructive Purpose:** Cost Audit has a constructive purpose as well. Cost Audit plays a constructive role by providing management of the company with information useful in regulating production, choosing economical methods of operation, reducing operation costs and reformulating plans etc. on the basis of his findings during the course of Cost Audit.

OBJECTIVE OF COST AUDIT:

Cost Audit has both general and social objectives.

The general objectives can be described to include the following:

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

Among the social objectives of cost audit, the following deserve special mention:

• Facilitation in fixation of reasonable prices of goods and services produced by the enterprise.

• Improvement in productivity of human, physical and financial resources of the enterprise.

• Channelizing of the enterprise resources to most optimum, productive and profitable areas.

• Availability of audited cost data as regards contracts containing escalation clauses.

• Facilitation in settlement of bills in the case of cost-plus contracts entered into by the Government.

• Pinpointing areas of inefficiency and mismanagement, if any for the benefit of shareholders, consumers, etc., such that necessary corrective action could be taken in time.

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 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.

PRINCIPLES OF COST AUDIT

1. Planning and Performing Cost Audit:

There are certain principles that the cost auditor has to observe in planning and performing the cost audit. There are also principles that the cost auditor has to see are being observed by the company he is auditing. On the one hand, the cost auditor has to safeguard his independence and professional status in planning and performing the cost audit, ensuring quality and standard of cost audit, as required by his professional body, the ICMAP, as well as by the Companies Ordinance 1984, and the Companies (Audit of Cost Accounts) Rules 1998, and other rules regulating his audit engagement and reporting. On the other hand, he has also to see that the client unit operates within the legal framework provided for the industry, maintaining cost accounting records, in accordance with the cost accounting records order rules applicable to the industry.

2. Code of Ethics:

Cost Auditor should comply with the ì code of ethics for professional accountants. The fundamental principles governing the professional responsibility of the Cost Auditors are enumerated as follows:

a. independence;

b. integrity;

c. objectivity;

d. professional competence and due care;

e. confidentiality;

f. professional behaviour; and

g. technical standards.

3. Independence of Cost Auditor:

The independence of the cost auditor is largely covered by the Companies (Audit of Cost Accounts) Rules 1998, under which a person who has or had specified relationships, which go to mar his independence, cannot be appointed as a cost auditor.

4. Integrity and Objectivity:

Integrity implies not only honesty but fair dealings and truthfulness. The principle of objectivity imposes the obligation on all professional accountants to be fair, intellectually honest and free of conflict of interest. Financial involvement with the client effects independence and may lead a reasonable observer to conclude that it has been impaired.

A professional cost and management accountant should be straightforward and honest in rendering professional services as a cost auditor. He has neither any ulterior motives nor any personal ends to serve. He should be fair and should not allow any prejudice or bias, conflict of interest or any other influence to override objectivity. Cost audit is to meet the management ſs and the Government ſs need for credibility in cost information and cost accounting systems.

5. Professional Competence and Due Care:

A professional accountant should not project himself as having expertise or experience which he does not possess. Attainment of professional competence requires a high standard of general education followed by specific education, training and examination in professionally relevant subjects and a period of work experience, with which all ICMAP members are equipped. Professional competence requires to be maintained by a continuing awareness of developments in the accountancy profession, including relevant national and international pronouncements on accounting, auditing and other relevant regulations and statutory requirements. The cost and management accountant has to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of competent professional service, based on up-to-date developments in practice, legislation and techniques.

6. Confidentiality:

A cost and management accountant should respect the confidentiality of information acquired during the course of performing professional services and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose. The duty of confidentiality continues even after the end of the relationship between the cost auditor and the client or the cost and management accountant and the employer.

7. Professional Behaviour:

A professional Cost and Management Accountant, being a member of the Institute of Cost and Management Accountants of Pakistan, should act in a manner consistent with the good reputation of the profession. He should meticulously avoid any such conduct or behaviour as may cast an unfavourable aspersion on the profession. He has to ensure professional behaviour while meeting his responsibilities to clients, third parties, other members of the cost and management accounting profession, staff, employers and the general public.

8. Technical Standards:

A professional Cost and Management Accountant should carry out professional services in accordance with the relevant technical and professional standards. A Cost and Management Accountant has a duty to render professional services with care and skill, in accordance with the instructions of the clients or employers, insofar as they are compatible with the requirements of integrity, objectivity, and in the case of Cost and Management Accountants in public practice, independence. Moreover, they have to conform to the technical and professional standards laid down by the Institute of Cost and Management Accountants of Pakistan, IFAC, IASC and the relevant laws, orders, rules and regulations.

9. Professional Code of Ethics:

A distinguishing mark of a profession is its acceptance of responsibilities to the society. The Cost Auditor is independence is to be judged by his clients, Government, employers, employees, investors in the business, the financial community and the consumers at large, who all rely on the objectivity and integrity of the Cost and Management Accountant. This reliance imposes a public interest responsibility on the professional cost and management accountant.

10. Engagement on other occupation:

A professional accountant in public practice should not concurrently be engaged in any business occupation and activity which might impair his integrity, objectivity or independence or the good reputation of the profession. The code of professional ethics of the Institute of Cost and Management Accountants must be carefully observed.

COST ACCOUNTING RECORDS:

The areas of activity in respect of which cost accounting records are to be maintained under Cost

(1) Raw Materials, Components, Stores and Spare Parts

(2) Salaries and Wages

(3) Service Department Expenses

(4) Utilities

(5) Depreciation

(6) Other Overheads

(7) Conversion Cost

(8) Research and Development Expenses

(9) Interest

(10) Joint Products and By-products

(11) Work in Progress and Finished Goods Stock

(12) Cost Statements

(13) Records of Physical Verification

(14) Packing

(15) Production Records

DUTIES OF THE COST AUDITOR:

The duties of the cost auditor are also similar to those of the (financial) auditor of the company has under sub-Section (1) of Section 227 (Section 223B(4)).The duties of the cost auditor inter-alia include:

(a) To ensure that the proper books of accounts as required by Cost Accounting Records Rules have been kept by the company so far as it appears from the examination of those books and proper returns for the purpose of his audit have been received from branches not visited by him;

(b) To ensure that the Cost Audit Report and the detailed cost statements are in the form prescribed by the Cost Audit Report Rules by following sound professional practices i.e. the report should be based on verified data and observations may be framed after the company has been afforded an opportunity to comment on them

(c) The underline assumptions and basis for allocation and absorption of indirect expenses are reasonable and are as per the established accounting principles;
(d) If the auditor is not satisfied in any of the aforesaid matters, he may give a qualified report along with the reasons for the same;

(e) Sending the Report to the Cost Audit Branch within 180 days from the end of the financial year with one copy to the company;

(f) Sending his replies to any clarification, that may be sought by the Cost Audit Branch on his report. Sending such replies within 30 days from the date of receipt of communication calling for such clarification.

POWERS/RIGHTS OF AN AUDITOR (255)

i) Right of access to books of account and vouchers 255(1).

ii) Right to receive information and explanations.

iii) Right of access to books and papers of branch 255(2).

iv) Right to receive notices of general meetings and to attend those meetings.

v) Right to make representation where another person is being appointed as auditor. (253(3)).

TYPES OF COST AUDIT:

The following are the important types of Cost Audit:

(1) Efficiency Audit

(2) Propriety Audit

(3) Statutory Audit

(1) Efficiency Audit: Efficiency Audit is directed towards the measurement of whether corporate plans have been effectively executed. It is concerned with the utilization of resources in economic and most remunerative manner to achieve the objectives of the concern. For example, the effective utilization of capital in an organization can be gauged by determining return on capital employed.

(2) **Propriety Audit:** Propriety Audit is concerned with executive actions and plans on the finance and expenditure of the company. The auditor has to judge whether the planned expenditure is designed to give optimum results. 672 A Textbook of Financial Cost and Management Accounting

(3) **Statutory Audit:** This type of audit is conducted in accordance with the provisions of Section 233B of the Companies Act 1956. It is the compulsory audit which required to maintain the related books and accounts of specified establishments. The chief aim of this types of audit is that the government wants to ascertain the relationship of costs and prices.

ADVANTAGES OR USEFULNESS OF COST AUDIT:

Besides the chief merit of detecting and preventing errors and frauds as in the case of audit in general, cost audit secures the following advantages to the management, shareholders and Government.

I. Usefulness to the Management:

(1) It ensures effective internal control.

(2) It provides necessary information for prompt decision making.

(3) It facilitates inter firm comparison.

(4) It helps to increase the overall efficiency of productivity.

(5) Inefficiency can be eliminated by suitable corrective actions.

(6) Errors, omission, fraud and mistakes can be detected and prevented due to effective

auditing of Cost Accounts.

(7) It facilitates cost control and cost reduction.

(8) It creates cost consciousness among employer and employees.

(9) It assists in valuation of stock of materials, work in progress and finished goods.

(10) It ensures maximum utilization of available resources.

II. <u>Usefulness to the Government:</u>

(1) Cost Audit helps in fixing contract price in cost plus contract.

(2) Helps in fixing of selling price for essential commodities.

(3) Enables Government to focus attention on inefficient work.

(4) Enables Government to give protection to certain industries.

(5) Facilitates settlement of trade disputes.

(6) It imposes an automatic check on inflation.

<u>III. Usefulness to the Shareholders:</u>

(1) It ensures more profit and high return to the shareholders.

(2) It creates an image of creditworthiness of the concern.

(3) It reflects a high degree of reliability to cost data.

(4) It ensures efficient management in utilization of plant and machinery, land and building, worker and employees etc.

<u>IV. Usefulness to the Society:</u>

(1) Cost audit is often introduced for the purpose of fixation of price. The prices so fixed are based on the correct costing data and so the consumers are saved from exploitation.

(2) Price increase by the industry is not allowed without proper justification as to increase in cost of production; consumers are saved from unreasonable price hike.

(3) Cost Audit is also useful for the purpose of Cost Control; Cost reduction and proper utilisation of scarce resources.

FINANCIAL AUDIT AND COST AUDIT:

Financial Audit:

(1) It is statutorily compulsory under Companies Act.

(2) It covers all the financial transactions recorded in financial books and financial records.

(3) It aims to examine that the business transactions have been recorded correctly.

(4) It is concerned with the past and historical in nature.

(5) Reporting the true and fair view of the company's earnings and state of affairs.

(6) Financial aspect of the accounts is a matter of concern.

(7) It is concerned with the scrutiny of reliability or otherwise of transactions.

Cost Audit

(1) It is not compulsory except in certain cases as provided under section 233B.

(2) It covers only cost records and cost accounts.

(3) It aims to verification of cost accounts and ensures the plan prepared in this connection has been duly executed.

(4) It concerned with forward looking approach.

(5) Cost Auditor is required to report to the management except statutory audit. Cost Audit

(6) Cost aspect of account is of main concern.

(7) It is concerned with the propriety and efficiency of the transactions.

COST AUDIT AND EFFICIENCY AUDIT

Efficiency Audit is systematic appraisal of management methods and is intended to assess the actual performance levels relative to applicable peer benchmarks or internal standards (e.g., profitability or stated business plan objectives etc.). The process is also designed to identify opportunities to ensure performance benefits. It aims at identifying efficiency and productivity improvement opportunities so that the resources flow into the most remunerative channels to ensure the optimum returns.

The parameters of measuring efficiency include overall rate of return, capacity utilization, utilization of national, financial, physical and human resources, cash flow performance and the payback period of the entire organization. Thus efficiency audit seeks to evaluate the overall organizational efficiency.

The cost audit report also mainly the comment on the efficiency of the company namely, utilization aspect of the factors of production. To enable the cost auditor to make efficiency audit, Section 209 (1) (d) of the Companies Act provides for "records of utilization of material, labour and other items of cost." Since a proper appraisal of the extent of efficiency of utilization of factors of production is possible in cost audit, it may appropriately be called efficiency audit.

The cost audit as efficiency audit can also be understood from the fact that cost audit reports enable the determination of accurate costs of production of various products, services and activities with a view to compare the same with the comparable figures of the earlier years and those of the peers or benchmarks in the industry. It seeks to identify the areas of inefficiency or poor decision making to ensure diversion of funds to most optimum channels. The information regarding exact unit costs after proper allocation of overheads, capacity utilization, per unit consumption of major raw materials (including power and fuel), man-hour productivity, idle hours or un-productive manpower wastage etc. serve as basis for efficiency audit and helps in fixing appropriate prices of goods and services produced by the company to ensure optimum returns. The detailed financial analysis of the company in cost audit report like determination and comparison of different ratios like 'profit as % of capital employed', 'profit as % of net sales', 'value addition', 'current asset as % of current liabilities', 'profit as

% of capital employed' etc. help in assessing the operational efficiency and comparing the financial health of the undertaking with the peers or others in the industry aiming at bringing all round efficiency.

COST AUDIT AND PROPRIETY AUDIT:

Propriety audit stands for verification of transactions in the best interest of the public, commonly accepted customs and standards of conduct. The term "propriety" has been defined by Kholer as "that which meets the tests of public interest, commonly accepted customs and standards of conduct and particularly as applied to professional performance, requirements of Government regulations, and professional codes." The tests boil down to consideration of financial prudence and economy, instead of too much dependence on documents, vouchers etc. It shifts the emphasis to find the wisdom and appropriateness of expenditure, rather than verifying whether it has been duly authorized or evidenced by proper vouchers etc. In other words, the propriety audit seeks to ensure that the planned expenditure would yield the optimum returns and there is no other better alternative available. It seeks to ensure that the expenditure is not only appropriate to the circumstances of each case, it has indeed achieved the objectives for which it has been incurred. The audit of public sector undertakings as undertaken by the Comptroller and Auditor-General of India is the best example of propriety audit.

The Cost Audit Reports can be termed as propriety audit as these reports seeks to ensure that actual expenditure at each stage is appropriate and optimum returns have been achieved. The cost auditor always aims at ensuring that the actual expenditure should not be prima facie more than what the occasion demands. The cost auditor has to report on matters which appear to him to be clearly wrong in principle, cases where the company's funds have been used in a negligent or inefficient manner, arm's length pricing of related party transactions, etc. These are the areas where the propriety aspect is involved and therefore cost audit may be in the nature of "propriety audit".

COST AUDIT AND MANAGEMENT AUDIT:

Cost audit report and the information to be furnished therein is prescribed by the Central Government. However, most of the information contained in the cost audit report is relevant for making managerial decisions. Normally a management audit is an audit for the management and by the management. Such audit looks into the economy and the effectiveness of performance of various activities of an organization. Cost audit also looks into the effectiveness of performance and efficiency in various areas such as capacity, input costs of materials, utilities and other controllable areas so far as the manufacturing aspect is concerned. Detailed information on these areas has to be given in the cost audit report by the cost auditor comparing it with the standards and past actual wherever necessary.

Since Cost Audit is very useful to the management as it points out areas where performance can be improved, it can be called an audit for the management. Though cost audit is not done at the behest of the management, it does not change its character from being a management tool.

COST AUDIT AND SOCIAL AUDIT:

Social audit is generally defined to be the audit of data or information depicting social performance of a business in contrast to its normal economic performance as measured in financial audit. A lot of research and experimentation are being conducted to device techniques or models, which can measure the contribution of an enterprise to the society. These developments result from an increasing realization of the fact that business undertakings have social responsibilities also and that the performance as a whole should be seen in this context.

Social performance is discharged by providing some social amenities for the use of community as a whole e.g. provision of a hospital, a recreation club, a temple, etc. As provision of such amenities involves diversion of profits earned by the business for charitable or philanthropic purposes, it is advisable to conduct an audit of such expenses spent on welfare which are in no way related to the main task of business of production or marketing of goods/services and earning profits. Such activities, which apparently are not directly connected with the main business activity, help the business to create a favorable image for the business and those at the helm of affairs

Cost audit provides an adequate information on the cost of production, selling price and margin of profit in respect of each item of product covered by cost audit. This information is very useful to the Government in regulating the prices of essential commodities. Therefore, cost audit can be said to sub serve the interest of the community by facilitating the review of prices to be charged to the customer. A review by the government results in fair prices to the consumers which is a major social objective which cost audit is sub serving. Thus cost audit is also a social audit.

CIRCUMSTANCES UNDER WHICH COST AUDIT IS DESIRABLE:

The following are the circumstances under which cost audit is ordered:

(1) Price Fixation

(2) Cost variation within the industry

(3) Inefficient Management

(4) Tax Assessment

(5) Trade Disputes

COST AUDIT PROGRAMME:

A suitable programme for cost audit should be drawn out in detail, specifying each item of audit work to be carried out. An audit programme is a written plan prepared by the Cost Auditor showing the following salient features:

1. How much work is to be done?
2. Who is going to do a particular portion of work?
3. And what is the duration of time by which the work is to be finished?

Prof. Meig defines "An audit programme is the detailed plan of auditing work to be performed specifying the procedures to be followed in verification of each item in the financial statements and giving the estimated time required."

Areas Of Cost Audit Programme Is Carried Out:

The areas which a cost audit programme should include are as below :

(1) Inventory of stores and work in progress

(2) Labour

(3) Overheads

(4) Selling, Distribution, Office and Administrative expenses

(5) Capital expenditure

(6) Utilization of capacity, plant and equipments

Advantages Of Cost Audit Programme:

The following advantages will accrue, if a cost audit is carried out with the help of a cost audit programme:

(1) It helps the auditor to know about the progress of audit.

(2) It increases the efficiency of the cost audit associates.

(3) It facilitates the uniformity in work.

(4) It helps to safeguard against omission.

(5) It guides for proper distribution of works and fixing responsibility.

(6) It serves as a defense against charge of negligence.

(7) It serves as a reference for the future audit of the same concern.

Disadvantages Of Cost Audit Programme:

There are certain disadvantages, if the cost audit work is carried out with the help of cost audit programme. They are as follows:

(1) For small concern, it would be unnecessary to prepare a programme.

(2) Audit associates have no interest and initative since, they perform their work mechanically.

(3) As each business has its own problems and procedures, a rigid audit programme cannot be laid for all types of business.

COST AUDIT ORDER:

Issue of Cost Audit Order

Issue of Cost Audit Order is the first step in Cost Audit of any company. The Central Government issues a specific order under Section 233(B)(1) of the Companies Act, 1956 on a particular company directing it to get its cost records audited by a practicing Cost Accountant indicating the product for which the order is issued and the period for which it is ordered. Therefore, the starting point for the cost audit exercise is the receipt of cost audit order by the company, specifying the year and the product for which such cost audit is to be conducted. However, the Cost Audit Branch has now been issuing Cost Audit Orders on regular basis to all the companies covered (i.e. every financial year thereafter continuously until further orders.) This amounts to saying that once an order is issued, the cost audit is required to be done every year unless it is specifically withdrawn. It may be clarified here that since the cost audit order issued by the Cost Audit Branch specifies the product, the Company need not have a cost audit for the product not specified in that order. Thus, if the company producing Sugar, Cement and Steel receives an order relating to Sugar for the year ending 31st March, 2009, then it need not get the cost records for products Cement and Steel audited under Sec. 233B for the year ending 31st March, 2009. Similarly for subsequent years also, it needs to get its cost records for Sugar only cost audited unless it gets a specific order on other products also.

Exemption from Cost Audit Orders

Even though there is no provision in the Companies Act, 1956 for grant of year-to-year exemption from Cost Audit, the exemption from Cost Audit on year-to-year basis is granted by Cost Audit Branch in situations arising out of temporary closure of the company and/or its manufacturing facilities, negligible production/activity, etc. These exemptions are based on logic that exemptions can be accorded by the executive since the cost audit orders are also issued by the executive. Applications for seeking exemption are required to be made to the Central Government, along with fee, as prescribed above for appointment of Cost Auditor. Following documents are required to be furnished along with application for exemption:

• Printed or attested true copy of complete Annual Report containing balance sheet and profit and loss account for the year for which exemption is being sought along with copies of the same pertaining to preceding two years. In case, exemption is being sought in the beginning of the financial year, the printed or attested true copy of Complete Annual Report for last three years may be provided.

• An affidavit containing full facts of capacity utilization, turnover and financial status of the company such as sick or not or such other grounds on the basis of which exemption is being sought, duly signed by two Directors of the company and authenticated by a Notary Public.

• A brief note/status report on steps taken by the management for revival of the company and/or the said unit.

Withdrawal of Cost Audit Orders :

Even though there is no provision in the Companies Act, 1956 for withdrawal of cost audit order, the withdrawal of Cost Audit is considered in case of permanent closure or sale or merger/amalgamation of production activities for the product under reference. These exemptions are based 25 Cost Audit & Operational Audit on logic that approval for withdrawal can be accorded by the executive since the cost audit orders are also issued by the executive.

Following documents are required to be furnished along with application for withdrawal:

• Printed or attested true copy of complete Annual Report containing balance sheet and profit and loss account for the year for which exemption is being sought along with copies of the same pertaining to preceding two years (or immediate last three years).

• An affidavit containing full facts of capacity utilization, turnover and financial status of the company such as sick or not, duly signed by two Directors of the company and authenticated by a Notary Public.

• Documentary evidences substantiating closure/winding-up, sale, merger, amalgamation, etc. e.g. Court's order, surrender of licenses, sale of plant and machinery, power disconnection, manpower reduction, etc.

PERFORMING COST AUDIT

1. **a) Knowledge of the industry and the entity:**

Before performing cost audit, the cost auditor must have or obtain knowledge of the industry and its business environments, sufficient to enable him, to identify and understand the events, transactions and practices that in the Cost Auditor's judgment may have a significant effect on the cost accounting statements of the entity to be audited, or on the cost audit report. The cost auditor should also have a general knowledge of the country's economy and the industry within which the entity operates. He should also have a clear understanding of the conditions that affect or may be affecting the cost and profit performance of the entity.

1. **b) Updating of knowledge of industry:**

The knowledge that the cost auditor obtains about the industry and the entity at the planning stage of the cost audit keeps increasing and updating, while taking up the assignment and at every stage throughout the performance of cost audit. The cost auditor keeps re-evaluating the knowledge and information gathered earlier.

Knowledge of the industry, which the cost auditor may already have, may be updated through discussions with the entity's senior operating personnel, publications relating to the industry, government surveys, statistics, trade journals, visit to the entity's premises and plant facilities. Knowledge of the industry and the entity is extremely important in cost performance evaluation.

The cost auditor should ensure that the assistants assigned to a cost audit engagement also obtain sufficient knowledge of the business to enable them to carry out the cost audit work delegated to them. It should be ensured that they understand the need to be alert for additional information and the need to share that information with the principal and other assistants.

1. **c) Legal and Regulatory Framework:**

When planning and performing cost audit procedures, the cost auditor should keep in view the legal and regulatory framework within which the entity has to operate. Although it is the responsibility of the management to ensure that the entity's operations are conducted in accordance with the laws and regulations and the cost auditor cannot be held responsible for non-compliance by the entity; he should see that the provisions of the Companies Ordinance 1984, the relevant cost accounting record order and of the Companies (Audit of Cost Accountings) Rules 1998 as far as they relate to the maintenance of cost accounting records and providing of cost accounting information, are duly observed and followed by the entity. Non-compliance of such provisions by the entity would have a material effect on the cost accounting statements, in which case the cost auditor is specifically required to report whether or not the entity complies with the provisions of laws or regulations which are directly related to cost audit.

2. Organisational Set-up:

While taking up any new cost audit assignment, the cost auditor should, first of all, study the organizational set-up of the entity. He should get familiar with the administrative, financial, buying and selling, production and planning functions at the entity. He should be introduced to the functional heads, as he will be dealing with them during the course of cost audit. Each function and sub-function should be organised in a logical manner, according to its nature and size. The size of and the manner in which the various functions are organised have a direct bearing on the cost of each function performed at the entity. The cost auditor will do well in discussing the functional set-up with the top management, pass on the concept of activity-based costing and also offer comments on the set-up, if considered necessary, under the circumstances. Knowledge of the organisational set-ups of each function helps in obtaining knowledge of the industry and the entity, referred to in the foregoing paragraphs.

The cost auditor has also to verify and express opinion on the company representations made under the Companies (Audit of Cost Accounts) Rules 1998, and on the cost accounting information provided by the company, in the Schedules and Annexures prescribed in the cost accounting records rules applicable. He has also to evaluate and offer comments on the entity's cost accounting system. He thus has to work, maintaining close liaison with the functional heads and with various levels of management.

3. Company Representations:

(a) a statement of productions capacity of the plant, in terms of machine hours and production units, the actual utilisation of the capacity and the reasons of difference between the two; and

(b) a stock-in-trade of the company as at the end of financial year in terms of quantity and cost thereof, distinguishing between:

i. Stock of raw material and components;

ii. Stock of work-in-process;

iii. Stock of finished goods; and

iv. Other stocks.

Under sub-rule 2 of Rule 4 of the Cost Audit Rules, (2) the statements specified in clauses (a) and (b) of sub rule

(1) Shall be signed by the chief executive and chief accountant of the company.. Both the statements specified in clauses (a) and (b) shall be submitted along with the Cost Auditor's report. Capacity as explained in para (1) of Appendix III of the Rules: .1. Capacity: (a) Licensed, installed and utilized capacities of the factory or factories for the product under reference.

(b) If the company is engaged in other activities besides the manufacture of the product under reference, give a brief note on the nature of such other activities.

4. Production:

After checking the stock-in-process at the end of the financial year with the production records and after adjusting the opening stock-in-process or last year's closing stock-in-process, .production in quantities of each type of product under reference' should be worked out, as required in para 3(a) of Appendix III (sub-rule (3) of Rule 4) of the Companies (Audit of Cost Accounts) Rules 1998. The .percentage of production of the product under reference, should be seen .in relation to the installed capacity.

If there is any shortfall in production as compared to the installed capacity, brief comments as to the reasons for the shortfall, shall be offered in the cost auditor's report. While laying down particulars to be included in cost auditor's report to the Directors of the Company, para 3(c) of Appendix III to the Companies (Audit of Cost Accounts), Rules 1998, further provides that .if there is any addition to the production capacity during the year under review or in the immediately preceding two years, this may also be mentioned.

GATHERING COST AUDIT EVIDENCE:

The cost auditor has to follow the International Audit Standards (IASs) and related technical pronouncements issued by International Federation of Accountants. Cost audit, like any other audit, involves: (a) planning (b) carrying out audit procedures or gathering cost audit evidence and (c) drawing reasonable conclusions on which to base the audit opinion. The principles and planning have generally been explained in Chapter III and IV of this Handbook, respectively. During the course of audit, the cost auditor should obtain sufficient appropriate audit evidence for arriving at reasonable conclusions. Audit evidence is the documented information obtained by the cost auditor in arriving at the conclusions, on which the audit opinion is based. Audit evidence will consist of source documents, cost accounting records, cost accounting statements, company representations and corroborating information from other sources. Cost audit procedures mean tests to obtain cost audit evidence to detect material misstatements in the statements and in the information provided by the entity. The tests may be performed on the details of transactions and balances, following analytical procedures. When obtaining cost audit evidence from substantive procedures, the cost auditor should consider the sufficiency and appropriateness of audit evidence from such procedures, together with any evidence from tests of control to support the cost and other information asserted by the management of the entity. If unable to obtain sufficient appropriate cost audit evidence, however, the cost auditor should express a qualified opinion or a disclaimer of opinion.

How Cost Audit Evidence is obtained?

Cost audit evidence is obtained by following procedures such as: inspection, observation, inquiry and confirmation, computation and analytical procedures noted below:

(i) Inspection consists of examining records, documents, or tangible assets. Inspection of records and documents provide cost audit evidence of varying degrees of reliability, depending on their nature and source and the effectiveness of internal control over their processing. Documentary cost audit evidences may be created by third parties and held by third parties or held by the entity or created by the entity and held by the entity.

(ii) The cost auditor may observe the procedures being performed, say the counting of inventories by the entity's personnel. Inquiry consists of seeking information from knowledgeable persons inside or outside the entity. Inquiries may be written or oral, providing new or corroborative information. Confirmation is the response to an inquiry.

(iii) Computations consist of checking the arithmetical accuracy of source documents and cost accounting records or of performing independent calculations. Analytical procedures consist of significant ratios and trends, including the resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or deviate from predicted amounts. Analytical procedures include the consideration of comparison of the entity's cost information for prior periods, anticipated results of the entity, such as budgets or forecasts or expectations of the cost auditor, such as an estimation of depreciation. The entity's cost perfomance may also be compared with similar industry cost information.

(iv) Analytical procedures also include consideration of relationships among elements of cost information that would be expected to conform to a predictable pattern based on the entity's experience, such as contribution analysis. Relationships also exist between such direct and indirect costs as payroll and employee related costs. Various methods may be used in perfoming analytical procedures, ranging from simple comparisons to advanced statistical techniques. Choice of procedures, methods and level of application is a matter of professional judgement.

The cost auditor should apply analytical procedures, when forming an overall conclusion as to whether the cost statements as a whole are consistent with the auditor's knowledge of the business. The conclusions drawn from the results of such procedures are intended to corroborate conclusions formed during the audit of individual components or elements of the cost accounting statements and assist in arriving at the overall conclusion as to the reasonableness of the cost statements. They may also identify areas requiring further procedures. The extent to which analytical procedures may be relied upon would depend on the materiality of the items involved.

(v) Cost audit evidence is obtained from an appropriate mix of tests of control and substantive procedures. The type of tests to be performed is important to an understanding of the application of audit procedures in gathering cost evidence. The cost accounting system is tested to identify the characteristics or attributes that indicate performance of a control, as well as possible deviations and conditions which indicate departures from adequate performance. The cost auditor should perform audit procedures appropriate to the particular test objective on each item selected.

(vi) The cost auditor should obtain sufficient appropriate audit evidence as to whether the standard cost, planned cost, budget cost or cost estimate, being used for cost accounting and control purposes, is reasonable in the circumstances. An understanding of the procedures and methods, including the cost accounting and cost control, used by the management in making the control yardstick is important for the cost auditor to plan the nature, timing and extent of the cost audit procedures. The cost auditor should either review and test the process used by the management to develop the standard; use an independent standard for comparison with that prepared by the management or review subsequent events which confirm the standard made.

(vii) The cost auditor should make a final assessment of the reasonableness of the standard estimate, based on the auditor's knowledge of the business and whether the yardstick is consistent with other audit evidence obtained during the audit. After an evaluation of results of cost audit procedures, the auditor should feel convinced of their being reasonable. Vouching, testing, examining, analyzing, comparing, confirming, inspecting, reconciling, tracing, verifying the details, the cost auditor collects audit evidence to form his opinion not only about the production and capacity utilisation, but also on the cost accounting system (Section VII), inventories and the cost accounting statements prepared by the management in accordance with cost accounting records order/rules, applicable to the industry. Cost statements differ from industry to industry and reflect how production and auxiliary services are generally organised.

(viii) The cost audit procedures outlined in the foregoing paragraphs are not only performed on the statements submitted by the company under the Companies (Audit of Cost Accounts) Rules 1998, but are also performed on the cost accounting records which the industry has to maintain under the cost accounting records order/rules. The cost accounting records order rules specifically mention the principal elements of cost involved in the production of the relevant product and specify adequate and proper accounting records for the same.

COMPANIES (COST AUDIT REPORT) RULES, 2011

These rules shall apply to every company in respect of which an audit of the cost records has been ordered by the Central Government under sub-section (1) of section 233B of the Act.

Every cost auditor appointed under sub-rule (2) shall, within thirty days of receipt of letter of appointment, inform his appointment to the Central Government through electronic mode, in the prescribed form, along with the requisite enclosures.

Notwithstanding anything contained in sub-rule (2) and (3) above, every company and every cost auditor shall follow the procedure prescribed vide Ministry of Corporate Affairs' General Circular No. 15/2011 [File No. 52/5/CAB-2011] dated April 11, 2011.

COMPLIANCES

- Maintenance of cost records is a pre requisite to conduct the Cost Audit.
- Every company including all units and branches.
- To be kept on regular basis to calculate per unit cost of production or cost of operation, cost of sales and margin.
- For each of its products and activities
- On monthly / quarterly / half-yearly / annual basis
- In accordance with the Generally Accepted Cost Accounting Principles and Cost accounting Standards issued by ICWAI.
- Variations are to be clearly indicated and explained.
- To achieve optimum economies in utilizations of resources.

- To be reconciled with the annual financial audited statements
- To be kept in good order for eight years.
- Every Cost Auditor shall also furnish performance appraisal report to the Board / Audit Committee of company
- Every Cost Auditor to reply to the clarifications, if any, sought by Central Government within 30 days of receipt of Communication FORM OF THE COMPLIANCE REPORT FORM – I
- General information about the company and the Cost Auditor. Attachment- Cost Audit Report as per the Companies (Cost Audit Report) Rules, 2011.
- FORM II - Cost Audit Report Annexure to the Cost Audit Report
- FORM III- Performance Appraisal Report TIME LIMIT FOR SUBMISSION

COMPLIANCE REPORT:

Time limit for submission of the compliance report – within 180 days from the close of the company financial year (before 30 June 2011 for the current year).AUTHENTICATIONOF ANNEXURE TOTHE COMPLIANCE REPORT

- Authentication of the Cost Audit Report and its annexure should be approved by the BOD before submitting to the Central Government by the Cost Auditor.
- The annexure duly audited by the Cost Auditor should be signed by the Company Secretary and at least one Director. If there is no Company Secretary, the same to be signed by at least two directors.

PENALTIES:

Cost accountant – If default is made in complying with the provision punishable with fine up to Rs. Five thousand. Company and officers – If default imprisonment up to 6months or Rs. 10,000/- or both.

FORM OF REPORT

- Every cost auditor, who conducts an audit of the cost records of the company, shall submit the report along with auditor's observations and suggestions, and Annexure to the Central Government in the prescribed form and at the same time forward a copy of such report to the company

- The cost audit report submitted on or after 1st day of April, 2012, irrespective of the financial year of the company to which it relates.
- Every company as specified in sub-rule (1) of rule 3 shall, keep and maintain cost details, statements, schedules, etc. for each unit and each product or activity comprised in each product group, duly authenticated by at least two Directors of the company and the cost auditor.
- The cost details, statements, schedules, etc. of every company, as specified in sub-rule (3), relating to a period of not less than eight financial years immediately preceding a financial year, shall be kept in good order.
- Every cost auditor, who submits a report under sub-rule (1), shall also give clarifications, if any, required by the Central Government within thirty days of the receipt of the communication addressed to him calling for such clarifications.

SUGGESTED STEP BY STEP APPROACH TO COST AUDIT:

Step 1

Please check and confirm applicability of provisions on your company as discussed in Groups A, B&C above.

Step 2

In case your company or any unit thereof falls in Group 'A' or Group 'B', then go for short listing a Cost Auditor to be appointed u/s 233B to comply with applicable provisions and obtain certificate of eligibility u/s 224(1B) and certificate of Independence (arm's length relationship with the company) followed by the reference to passing of board resolution for appointment of cost auditor, reference to audit committee, online filing of Form23C with the Central Government etc.,

Step 3

In case your company or any unit thereof falls in Group 'C', then go for short listing a Cost Accountant (either in service in your company or in independent practice) for ensuring issuance of Certificate of Compliance

Step 4

In case your company or any unit there of falls in Group 'A' ,then go for completion/ compilation of Cost Accounting Records as per Cost Accounting Records as applicable on your industry (one of the 8 notified).

- In case your company or any unit thereof falls in Group 'B' , then go for completion of Cost Accounting Records for the F.Y. 2011-12, and for previous two years i.e. F.Y. 2010-11 & 2009-10, as per Companies (Cost Accounting Records) Rules, 2011.
- In case your company or any unit thereof falls in Group 'C' , then go for completion of Cost Accounting Records for the F.Y. 2011-12, as per Companies(Cost Accounting Records) Rules, 2011.
- In case your company or any unit thereof falls in Group 'B' , then go for completion of Cost Accounting Records for the F.Y. 2011- 12, and for previous two years i.e. F.Y. 2010-11 & 2009-10, as per Companies (Cost Accounting Records) Rules, 2011.
- In case your company or any unit thereof falls in Group 'C' , then go for completion of Cost Accounting Records for the F.Y. 2011-12, as per Companies (Cost Accounting Records) Rules, 2011.

Step 5:

At the end of the financial year, complete these records and get them Cost Audited or get Certificate of Compliance issued from the Cost Accountant/Auditor, as the case may be.

Step 6:

Make the necessary disclosures in the Annual Report of your company.

COST REDUCTION AND COST CONTROL:

Cost reduction:

Cost reduction is the process used by companies to reduce their costs and increase their profits. Depending on a company's services or Product, the strategies can vary. Every decision in the product development process affects cost.

Companies typically launch a new product without focusing too much on cost. Cost becomes more important when competition increases and price becomes a differentiator in the market.

<u>Cost Control:</u>

There is no exact rule or definition of cost control. The term, cost control, implies the usage of policies and internal rules that help you to reduce the cost of a particular management process. Cost control methods target the reduction of cost, and maintenance of quality and quantity of a particular production process or service generation.

Cost control is concerned with keeping the expenditure within acceptable limits. Its major assumption is that costs are in control unless costs exceed budget or standard by an excessive amount.

DIFFERENCES BETWEEN COST CONTROL AND COST REDUCTION:

COST CONTROL	COST REDUCTION
Controls costs towards achievement of predetermined target or goals.	Represents real and permanent decrease in costs.
It is a routine exercise	It is a planned process.
It is a preventive function	It is a corrective function.

FORM OF THE COST AUDIT REPORT

This e-form has been taken on file maintained by the Central Government through electronic mode and on the basis of statement of correctness given by the filing company and the cost auditor

FORM-II

FORM OF THE COST AUDIT REPORT

I/We, ……………………… having been appointed as Cost Auditor(s) under Section 233B of the Companies Act, 1956 (1 of 1956) of ………………… (*mention name of the company*) having its registered office at ……………………………… (*mention registered office address of the company*)(hereinafter referred to as the company), have audited the books of account prescribed under clause (*d*) of sub-section (1) of section 209 of the said Act, and other relevant records in respect of the ………………………………… (mentions name/s of product group/s) for the period/year ……………………………….. (mention the financial year) maintained by the company and report, in addition to my/our observations and suggestions in para 2.

(*i*) I/We have/have not obtained all the information and explanations, which to the best of my/our knowledge and belief were necessary for the purpose of this audit.

(*ii*) In my/our opinion, proper cost records, as per Companies (Cost Audit Report) Rules, 2011 prescribed under clause (*d*) of sub-section (1) of section 209 of the Companies Act, 1956, have/have not been maintained by the company so as to give a true and fair view of the cost of production/operation, cost of sales and margin of the product/activity groups under reference.

(*iii*) In my/our opinion, proper returns adequate for the purpose of the Cost Audit have/have not been received from the branches not visited by me/us.

(*iv*)In my/our opinion and to the best of my/our information, the said books and records give/do not give the information required by the Companies Act, 1956, in the manner so required.

(*v*) In my/our opinion, the said books and records are/are not in conformity with the Cost Accounting Standards issued by The Institute of Cost and Works Accountants of India, to the extent these are found to be relevant and applicable.

(*vi*)In my/our opinion, company has/has not adequate system of internal audit of cost records which to my/our opinion is commensurate to its nature and size of its business.

(*vii*) Detailed unit-wise and product/activity-wise cost statements and schedules thereto in respect of the product groups/activities under reference of the company duly audited and certified by me/us are/are not kept in the company.

(*viii*)As required under the provisions of The Companies (Cost Audit Report) Rules, 2011, I/we have furnished Performance Appraisal Report, to the company, on the prescribed form.

Observations and suggestions, if any, of the Cost Auditor, relevant to the cost audit.

Dated: this __________ day of _____________ 20______

at _____________ (mention name of place of signing this report)

SIGNATURE & SEAL OF THE COST AUDITOR (S)

MEMBERSHIP NUMBER (S)

NOTES:

(1) Delete words not applicable.

(2) If as a result of the examination of the books of account, the Cost Auditor desires to point out any material deficiency or give a qualified report, he shall indicate the same against the relevant paras (*i*) to (*viii*) only in the prescribed form of the Cost Audit Report giving details of discrepancies he has come across.

(3) The report, suggestions, observations and conclusions given by the Cost Auditor under this paragraph shall be based on verified data, reference to which shall be made here and shall, wherever practicable, be included after the company has been afforded an opportunity to comment on them.

ANNEXURE TO THE COST AUDIT REPORT

1. GENERAL INFORMATION:

1. CIN or GLN of the company:

2. Name of the company:

3. Registered office address:

4. Corporate office address:

5. E-mail address of the company:

6. Company's financial year to which the Cost Audit Report relates:

7. Name, address, membership number and e-mail of the Cost Auditor(s):

8. SRN Number and date of Filing of Form 23C with the Central Government:

9. Date of Board of Directors' meeting wherein the Annexure to the cost audit report were approved:

10. No. of Audit Committee meetings held by the company, and attended by the Cost Auditor during the (*sic*.)

PROFORMA

Product Group Details (for company as a whole)

Sr. no.	Name of each Product Group	Names of Products/ Activities included in the Product Group	Net Sales (net of taxes, duties, etc.) (₹ lakh)	Covered under cost audit (yes/no)
A.	Manufactured Product Groups			
	1.			
	2.			
	3.			
	4. etc.			
	Sub-total (A)			
B.	Services Groups			
	1.			
	2.			
	3.			
	4. etc.			
	Sub-total (B)			
C.	Trading Activities (Product Group-wise)			
	1.			
	2.			
	3.			
	4. etc.			
	Sub-Total (C)			
D.	Other incomes			
E.	Total Income as per audited annual report (A+B+C+D)			

Notes:

1. For manufactured product groups, use the nomenclature as used in the Central Excise Act and rules, as applicable.

2. For service groups, use the nomenclature as used in the Finance Act/ Central Service Tax rules, as applicable.

Quantitative Information (for each product group separately)

Name of the company:

Name and address of the factory:

Name of the product:

Statement showing the cost of production, cost of sales, sales realization and margin in respect of the product(s) under reference produced during the year/period.

A. Quantitative Information.

Sr.no	Particular	(Unit of measurement to be specified) Current yr previous yr	
1	I) Installed capacity II) Capacity enhanced during the year by leasing arrangement etc.		
2	Actual production/ output. I. self; II) third parties, if any;		
3	Production as percentage of installed capacity		
4	Captive consumption, if any		
5	Quantity sold a. domestic b. export		
6	Closing stock (finished goods)		
7	Opening stock (finished goods)		

B. Cost information.

Sr.no	particular	Qty unit	Rate/ unit	Amount	Cost per unit Current Yr	Prev.Yr
1	Material consumed. (item-wise covering at least 80% of items by value) 1. Purchase. a. indigenous(specify) b. imported(specify) 2. self manufactured(specify)					
2	Process chemicals (specify)					
3	Utilities 1. Purchase. • indigenous(specify) • imported(specify) 2. self manufactured(specify)					
4	Direct wages and salaries					
5	Consumable stores and spares					
6	Depreciation					
7	Lease rent, if any					
8	Repair and maintenance. a. Building b. Plant and machinery c. Others, if any					
9	Other works overhead					
10	Total works overhead (2 to9)					
11	Royalty, if any					
12	Technical assistance/know-how fee					
13	Research and development					
14	Quality control					
15	Administrative overhead (relating to production activities) a. salaries and wages b. others (specify)					

	c. Total (a+b)					
16	Total(1+10to 15					
17	Adjustment fir variances (where standard costing system is followed)					
18	Add. Opening stock Less. Closing stock (Work-in-progress)					
19	Less. Credits (from wastage and by-product) / recoveries, if any					
20	Packing cost primary a. Material b. Others c. Total					
21	Cost of production(16 to 20)					
22	Finished goods purchased, if any					
23	Opening stock Closing stock (finished products)					
24	Total (21+22+23)					
25	Quantity and cost transferred for. I. captive consumption, if any II) sales III) Others. If any					
26	Packing cost secondary a. material b. others c. total					
27	Other expenses. a. Administrative overheads(others) b. Others(specify)					
28	Selling and distribution expenses a. Salaries and wages b. Fright and transport charges c. Commission to selling agents d. Advertisement expenses e. Royalty on sales, If any f. Warranty expenses after adjusting income from chargeable services g. Others h. Total (a to g)					

29	Interest and finance charge. a. for manufacturing activity b. others c. total					
30	Total cost of sales (excluding excise duty) of packed quantity sold (24 to 29)					
31	Sales realisation Less. excise duty and other statuary levies					
32	Net sales realisation					
33	Margin (32-30)					
34	Add. export benefits and incentives, if any					
35	Total margin (including export benefits)					
36	Ex-factory price(excluding sales tax etc)					
37	Maximum retail price)excluding sales tax etc.					
38	Maximum retail price, if any, prescribe by the government/statutory/regulatory body etc.					

Notes:

(1) Separate Performa shall be prepared for each type/variety/description of products(s) under reference.

(2) Separate Performa shall be prepared for the quantity used for captive consumption, quantity sold within the country and the quantity exported. Expenses incurred on export and the incentives earned thereon shall be indicated in the proforma applicable for the quantity produced and exported.

(3) Separate proforma shall be prepared for any related party/inter-unit transfer of intermediate/finished product(s) under reference.

(4) The administrative overheads shall be included in the cost of production only to the extent they contribute in putting the goods produced to their present location and condition. The balance of administration overheads, if any, shall be included in the cost of goods sold. The proforma may be amended accordingly, if required.

(5) The profroma may be suitably modified to cover the special features. If any, of the product under reference on the basis of proforma prescribe for working out cost of sales, margin, etc. of the said product in the relevant Cost Accounting Records Rules.

(6) Indicate whether the price of the product under reference are ex-factory price, F.O.R price, door delivery price or any other terms. In case of ex-factory price, whether cost of dispatch

(7) packing materials, fright, insurance, and delivery charge are recoverable from the customers separately.

CONCLUSION

Cost Audit represents the verification of cost accounts and check on the adherence to cost accounting plan. Cost Audit ascertain the accuracy of cost accounting records to ensure that they are in conformity with Cost Accounting principles, plans, procedures and objective

Cost audit report is an effort to simplify cost audit reports and make them less bulky.

Cost audit is an examination of cost accounting records and verification of the facts to ascertain that the cost of the product under reference has been arrived at in accordance with principles of Cost Accounting and evaluation of adequacy of proper Cost Accounting Records and their maintenance.