K.T.S.P.Mandal's

SAHEBRAOJI BUTTEPATIL MAHAVIDYALAYA

Rajgurunagar, Tal-Khed, Dist-Pune, 410505

DEPARTMENT OF COMMERCE

T.Y.B.COM

SEM-VI

Subject

Cost and Works Accounting-III

Chapter 4
Cost Accounting Record Rules
&
Cost Audit

Chapter 4
Cost Accounting Record Rules & Cost Audit

COST AUDIT AND RECORDS - SECTION 148 OF THE COMPANIES ACT, 2013

The Central Government may direct any class of companies engaged in production of such goods or providing such services as may be prescribed to include in the books of accounts particulars relating to utilization of material or labour or such other items of cost.

Further the Central Government may also direct the audit of cost records of the company. The Companies (Cost Records and Audit) Rules, 2014 are applicable to every company registered under the Act which is engaged in the production of goods or providing services listed in Table-A or Table-B of Rule 3. Different threshold limits have been prescribed in the Rules for applicability of maintenance of cost accounting records and coverage under cost audit.

COST RECORDS

1. "Cost Records" means books of account relating to utilization of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in Section 148 of the Act and these rules.

2. Every company specified in item (A) of rule 3 shall get its cost records audited in accordance with these rules if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees fifty crores or more as the aggregate turnover of the individual.

COST AUDIT

Meaning

Cost audit is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilization of material or labor or other items of costs, maintained by the company. In simple words the term cost audit means a systematic and accurate verification of the cost accounts and records and checking of adherence to the objectives of the cost accounting.

As per ICWA London' "cost audit is the verification of the correctness of cost accounts and of the adherence to the cost accounting plan."

Scope of Cost Audit

The scope of cost audit has two important aspects:

1. Propriety audit
2. Efficiency audit

1. Propriety Audit

This aspect of a cost audit is concerned with the actions and plans of management that affect the finance and expenditure of the business concern. Under this aspect, the cost auditor is required to ensure that an item of expenditure is sanctioned or approved by the proper authority. It is done with the help of documents and vouchers. In addition, the cost auditor must ensure that the item of expenditure is proper and reasonable on the grounds of propriety. Thus, the cost auditor has to report:

- Whether or not the planned expenditure can yield optimal results
- Whether or not the size or channels of investment were designed to produce the best results
- Whether the return on investment in certain channels could be improved by another plan of action

2. Efficiency Audit

This aspect of a cost audit focuses on performance evaluation. In particular, it covers the verification of the facts (i.e., that the expenditure has been incurred according to the plan and the results obtained have also been produced according to the plan).

The efficiency aspect of a cost audit involves examining the plan prepared in the form of budgets (financial and functional) and the comparison of the actual performance with the budgeted performance. The reasons for any variance are also analyzed.

Thus, the efficiency audit ensures that:

- Every dollar invested in capital or other areas yields the optimal return
- Investment in different spheres of the business is balanced to yield the optimal results
- Therefore, the cost auditor plays the role both of a consultant and a financial adviser. They assist the chief executive of the business in judging the soundness of the financial plans and performance by coordinating the results of the actions of various department leaders.

Applicability of Cost Audit

Cost audit applicability provisions are contained under rule 4 of the Companies (Cost Records and Audit) Rules, 2014. According to the said rule 4, the cost audit is applicable in the following situation –

A) Table A specified goods/services –

Overall annual total turnover of the company from all the products/services is INR 50 Crore or more; and Aggregate turnover from the individual product/service for which cost records are required to be maintained is INR 25 Crore or more.

B) Table B specified goods/services –

Overall annual total turnover of all the products/services should be INR 100 Crore or more; and Aggregate turnover from the individual product/service for which cost records are required to be maintained should be INR 35 Crore or more.

It must be noted that for the purpose of examination of applicability of cost audit the immediately preceding financial year turnover is to be considered.

Non-Applicability of Cost Audit Requirement

1. The companies which are covered under rule 3 are not required to get their cost records audited in case of the following situation –
2. The company's export revenue exceeds 75% of its total revenue. The export revenue needs to be in foreign exchange; or
3. The company which is operating from the special economic zone;
4. The company which is engaged in the generation of electricity for captive consumption through Captive Generating Plant.

OBJECTIVES OF COST AUDIT

The following are some of the objectives for which cost audit is under taken:

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.

ADVANTAGES OF COST AUDIT

A) To the Management:

1. Cost audit helps in detection of errors and frauds.
2. The management gets accurate and reliable data based on which they can make day-to-day decisions like price fixation.
3. It helps in cost control and cost reduction.
4. It facilitates the system of standard costing and budgetary control.
5. It helps the management in inter-unit / firm comparison.
6. It enables the management to identify loss making propositions.

B) To the Government:

1. Cost audit ensures efficient functioning of the industry. This in turn, nurtures a healthy competition among the different companies and paves a path for fast progress.
2. It helps in identification of sick units and enables the Government to make relevant decisions.
3. It helps in fixing prices in the case of essential commodities and checking undue profiteering.

4. It enables to take decisions as to granting of subsidies, incentives and protection to various industries.
5. It helps to take decisions as to levies, duties and taxes.

C) To the Society:

1. Cost audit enables the Government to fix prices of essential commodities. This safeguards the interests of the society.
2. Cost audit enables the Government to keep a check on undue profiteering by the manufacturers and avoids artificial price rise due to monopolistic tendencies.

D) To the Shareholders:

1. Cost audit reveals whether any of the products of the company are making losses. Thus though the company making an overall profit, a loss making line may eat up the company's profits. This is brought to the notice of the shareholders and the management is forced to take remedial measures, thereby making optimum utilization of resources.
2. Cost audit ensures that the shareholders get a fair return on their investments.

DISADVANTAGES OF COST AUDIT

1. Holding a Cost Audit can be expensive. This is because a company will often bring in an independent auditor who are normally charging higher price.
2. A Cost Audit can be a long process which will likely involve more time. This extra time and effort can impact an employee's day to day routine work.
3. If a Cost Audit is carried out in order to find fraudulent activity it can take a long time by which time people stealing could have covered their tracks.
4. Cost Audits involve a large amount of estimation and so there is the possibility that figures will be incorrect and if record keeping from the company is not good to start with then inaccuracies will be arises.

QUALIFICATIONS OF COST AUDITOR

A person who is proposed to be appointed as cost auditor of a company must possess the following qualifications:

1. He / she must be a Cost Accountant as defined in clause (b) of subsection (1) of section 2 of the Cost and works Accountants Act, 1959 (23 of 1959).
2. He / She must hold a valid certificate of practice issued by the Council of the Institute of Cost and Works Accountants of India under Section 7 of the Cost and Works Accountants Act, 1959.

DISQUALIFICATIONS OF COST AUDITOR

A person cannot be appointed as a cost auditor of a company if he attracts any of the disqualifications listed in sub-sections (3) and (4) of section 226 of the companies act, 1956. the relevant sub-sections provide that the following cannot be appointed as a cost auditor

(These are also applicable to a financial auditor of a company):

1. A body corporate.
2. An officer or employee of the company.
3. A person who is a partner, or who is in the employment of an officer or employee of the company.
4. A person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount already specified;
5. A person who is disqualified to be the cost auditor of its subsidiary or holding company or of another subsidiary of its holding company.

RIGHTS OF A COST AUDITOR:

A cost auditor has the same rights in relation to an audit conducted by him under Section 233-B as an auditor of a company under Section 227(1).

Following are his rights:

(i) He has a right of access at all times to the books of accounts and vouchers of the company.

(ii) He has a right to get such information and explanations from the officers of the company as he may think necessary for the performance of his duties as an auditor.

(iii) He has a right to get all facilities and assistance from the company to perform his duties as an auditor.

(iv) The company and every officer, in default of not providing the accounts, vouchers, information, explanations etc. to the auditor, shall be punishable with fine.

DUTIES AND RESPONSIBILITIES OF A COST AUDITOR:

The main duties and responsibilities of a cost auditor are:

(i) He is liable to the Company if he does not perform his duties properly or is guilty of negligence.

(ii) He also owes a legal responsibility to third parties who might have been misled by his audit certificate and acted in reliance thereon.

(iii) He should maintain his working papers as an evidence of his having carried out his duties.

(iv) He should not disclose any confidential information which he might have acquired in the course of his work and should not use such information for personal gain or gain of a third party.

(v) He is responsible to answer any query required by the Central Government on a scrutiny of the cost audit report submitted by him.

(vi)He is criminally liable for falsification of books. If he is found guilty of falsification, he shall be punishable with imprisonment for a term which extends to seven years and he shall also be liable to fine in addition.

COST AUDIT PROGRAM

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

How much work is to be done?

Who is going to do a particular portion of work?

And what is the duration of time by which the work is to be finished?

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

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

- Inventory of stores and work in progress;
- Labor;
- Overheads;
- Selling, distribution, office and administrative expenses;
- Capital expenditure;
- Utilization of capacity, plant, and equipment.

Advantages of Cost Audit Program

1. It helps the auditor to know about the progress of the 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 a charge of negligence.
7. It serves as a reference for future audits of the same concern.

Disadvantages of Cost Audit Program

1. There are certain disadvantages if the cost audit work is carried out with the help of a cost audit program. They are as follows:
2. For small concern, it would be unnecessary to prepare a program.
3. Audit associates have no interest and initiative since they perform their work mechanically.

COST AUDIT REPORT

On completion of an audit, an auditor has to submit his audit report incorporating a certificate regarding the correctness or otherwise of accounts along with his suggestion, if any, for improvements in the operation. The report should be concise and submitted to the appropriate authorities at the right time to be of effective use to the parties concerned. It should comply with statutory provisions, if any.

Annexure to Cost Audit Report

Generally, a cost audit report contains the following matters.

1) General Information:

This includes;

- Name and address of the concern/firm.
- Date of the company’s registration.
- Types of company i.e., public or private.
- Brief description of the company’s function.
- Location of the factory.
- Opening date of commercial production.
- Types of accounts.
- Production capacity.

2) Cost Accounting System:

Here, the cost auditor mentioned whether the accounts are maintained according to the GAAP or cost accounting system. Generally, cost accounting methods include;

- Cost accounting system regarding materials.
- Cost accounting system regarding labor.
- Depreciation, overhead, and its allocation on production cost.
- The condition of by-product, joint product, etc.

3) Financial Position: It includes;

- Capital employed.
- Net worth.
- Profit before tax.
- Expenses to be specified.

Reference:-

- Techniques of Cost Accounting- Dr, Suhas Mahajan & Dr, Mahesh Kulkarni, Nirali Prakashan
- Costing Techniques and Cost Audit- Dr. Arun Gaikwad , H. M. Jare , Dr. Kishor Jagtap , Dr. Sunil Zagade , Success Publications
- https://www.mbaknol.com/financial-management/cost-audit/
- https://learn.financestrategists.com/explanation/management-accounting/cost-audit/
- https://www.iedunote.com/cost-audit