

Strategic Cost Accounting

M. Com (Semester IV)

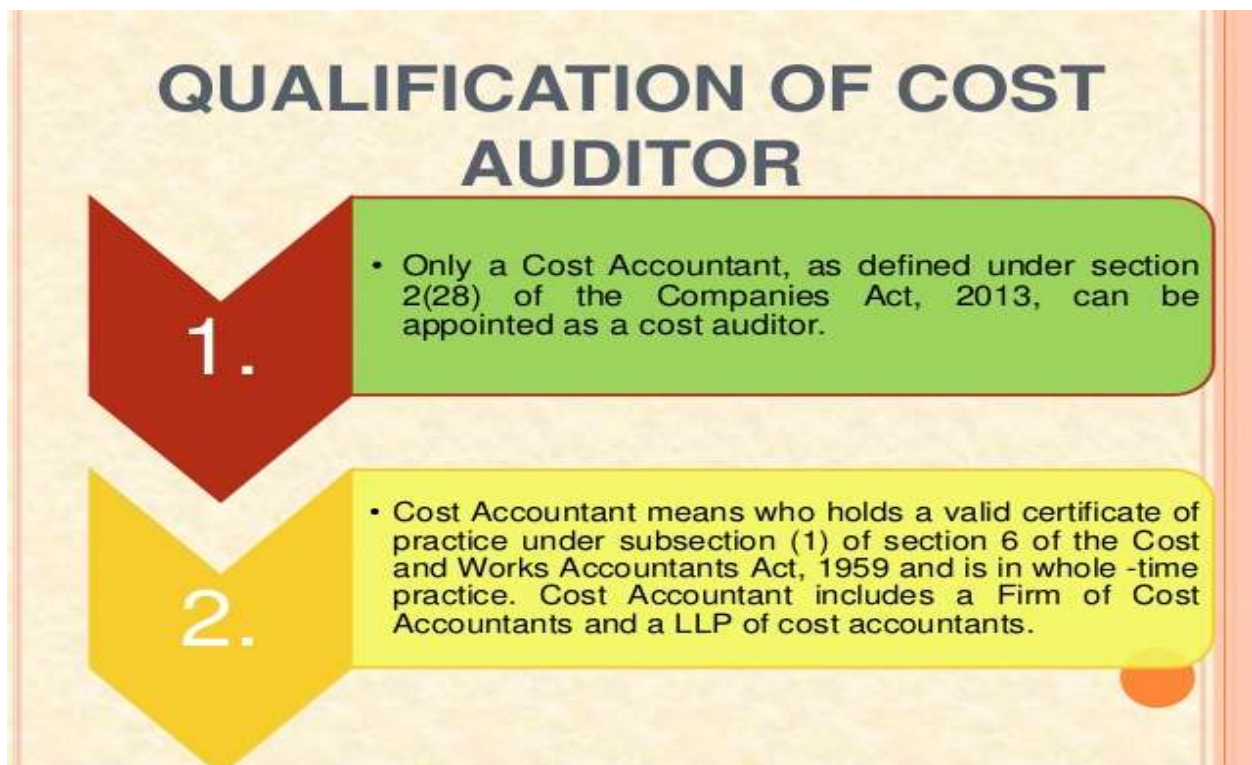
Topic- Cost Audit

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What is Cost Audit?

Cost Audit is the process for verifying the cost allocation of each product or Services comprising of labour cost, manufacturing cost or any other item of cost as applicable. It is a critical review undertaken to verify the correctness of Cost Accounts and to check that cost accounting principles and planning have been efficiently followed. Cost Audit has been defined by the Chartered Institute of Management Accountants (CIMA) of Landon as “the verification of cost accounts and a check on the adherence to the cost accounting plan.” Thus, the Cost Audit is quite different from the Financial Audit. It is to see whether the labour is efficient or not, whether the industry has provided efficient labour or the labour which is required by that industry is less than what is required, whether every material and every part of the machinery is used to the optimum, whether any material is wasted, etc.

It is noteworthy that India is the only country which has introduced statutory cost audit to regulate about 45 vital industries of the country. According to ICWA of India, ‘Statutory Cost Audit is a system of audit introduced by the Government of India for the review examination and appraisal of the cost accounting record and added information required to be maintained by specified industries.’



Appointing Authorities of Cost Auditor

By Internal Authorities

- Internal authorities i.e., by the same management to conduct cost audit as an aid to management.

By External Authorities

- Government to conduct audit on behalf of Government.
- Customer to carry out cost audit on behalf of customer.
- Trade association or tribunal to facilitate cost audit on behalf of trade association or tribunal.

Functions of Cost Audit

The main functions of cost audit are as follows-

1. To verify that the cost accounts are correctly kept in accordance with the principles of costing employed in the industry;
2. To ensure that the cost accounting routine laid down by the business is properly carried out;
3. To detect errors and prevent frauds and possible misappropriation.

Advantages of Cost Audit

The chief advantage of a cost audit will be that management will be sure to get reliable data for its objectives — price fixing, decision-making, control, etc. Existence of such a system of audit will also be of great use for maintaining internal check and control and will be of great help to even financial audit. In brief, the advantages of cost audit are as follows-

1. A close check will be maintained on all wastages—materials in store, labour, etc. and they will be promptly located and reported.
2. It also helps in pointing out any inefficiencies in the production process. Solving such inefficiencies will help the company save a lot of money.
3. A cost audit actually helps the statutory auditor with his job as well. Audited costing data helps him determine the value of stocks, managerial remuneration, and other such aspects.
4. Cost auditing also allows fixing individual responsibility. This will allow the management to effectively manage their staff. Through fixation of individual responsibility, management by exception will be possible.
5. The system of budgetary control and standard costing will be greatly facilitated with cost audit at the hands of a qualified cost accountant.
6. Records will be up-to-date and information for various purposes will be available.
7. Cost audit may unearth a number of errors and frauds which may not be revealed otherwise. This is because a cost auditor examines expenditure minutely and compares it with standards and ascertains exact reasons for discrepancy.
8. Cost audit can serve to measure performance of managers and better performance can be rewarded.

9. Inter-firm comparisons can be made with ease and this might be a very useful proposition if industrial intelligence is good.
10. If the cost auditor is an outsider and is an expert, he can certainly give some practical and sound advice to streamline costing systems and organisation.

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 arising.

Difference between Financial Audit and Cost Audit

Financial Audit	Cost Audit
Financial aspect of the accounts is a matter of concern.	Cost aspect of account is of main concern
It is concerned with the scrutiny of reliability or otherwise of transactions	. It is concerned with the propriety and efficiency of the transactions
Financial audit may be needed in both trading or non- trading	Cost audit is needed mainly in trading where cost is involved
Financial audit is based on micro approach	Cost audit follows macro approach
Financial audit examines the accounts of the whole business	Cost audit conducted to examine a product or a factory of the business
Financial auditor is appointed by the members in the general meeting of a company as an ordinary business	Cost auditor is appointed by the board of directors of the company with the previous approval of the Government of India

Types of Cost Audit

The main types of cost audit are as follows-

1. **Cost Audit to Assist Management:** The aim is to see that all information placed before management is relevant, reliable and prompt so that management can discharge its duties well.
2. **Cost Audit on Behalf of a Customer:** Often contracts are placed on “Cost Plus” basis. In other words, the customer will determine the final price to be paid on the basis of exact cost plus an agreed margin of profit. The customer, in such a case, usually gets cost accounts of the product concerned audited to establish correct cost and, therefore, price.

3. **Cost Audit on Behalf of Government:** Sometimes the Government is approached with request for financial help or protection. Before taking a decision on the request, the Government may choose to get cost accounts of the applicant audited to establish whether the need for help is genuine or is a result of mere inefficiency.
4. **Cost Audit under Statute:** The Amendment Act of 1965 has inserted a new section, 233B, in the Companies Act, 1956 whereby the Central Government may order that certain classes of companies will get their cost accounts audited by a member of the Institute of Cost and Works Accounts of India. Only such companies as are required to maintain proper records regarding materials consumed, labour and other expenses under Section 209 (as amended to date) and may be required to get their cost accounts audited.
5. **Cost Audit on Behalf of the Trade Association:** Sometimes trade associations seek to maintain prices at a certain level. For this purpose, the accuracy of costing information submitted by various concerns has to be checked. The trade associations may seek to have full information about production capacity and the relative efficiency of productive processes.

Provisions of Cost Audit under Companies Act, 2013

Provisions relating to cost audit are contained under section 148 of the Companies Act, 2013. The salient feature of section 148 are narrated here under –

1. Central Government may order the certain class of companies, engaged in the production of such goods or provision of such service, to maintain particulars relating to utilization of material or labour or to other items of cost to be included in the books of accounts of the companies;
2. Central Government may direct certain class of companies, based on the net worth or turnover of the companies, to get an audit of cost records of such companies;
3. The cost accountant, who shall conduct the audit of cost records of the company, needs to be appointed by the Boards and remuneration of such cost accountant needs to be fixed by the Board on the basis of the determination by the members;
4. The person appointed as auditor of the company cannot be appointed for conducting an audit of cost records of the company;
5. The company needs to submit to the Central Government a copy of cost report, within a period of 30 days from the date of receipt of the copy of cost audit report, along with full information and explanation on every reservation / qualification contained in the report.'

Applicability of Cost Audit under the Companies Act, 2013

Under the Companies Act, 2013, it has categorized the Company industrial activity into two parts i.e.

(A) Regulated Sector (Table A): It covers the industry like Petroleum products, Drugs and Pharmaceuticals, Fertilisers, Sugar and Industrial alcohol, etc. if these companies fulfil the criteria which are mentioned below need to appoint the Cost Auditor of the Company.

- The company having overall annual turnover from its product and services during the immediately previous financial year is Rs. 50 crore or more.

- The company having aggregate turnover of the individual product or services is for Rs. 25 crore or more

(B) Non-Regulated Sector (Table B): It covers the Industry like Turbo Jets and turbo propellers, Arms and Ammunitions, Cement, coffee and tea, Ores and Mineral products, Milk Powder, tyres and tubes, etc. If such companies fulfil the criteria which are mentioned below need to appoint the Cost Auditor of the Company.

- The company having overall annual turnover from its product and services during the immediately previous financial year is Rs. 100 crore or more.
- The company having aggregate turnover of the individual product or services is for Rs. 35 crore or more

Exemption from Cost Audit-

Following are the exemption towards the cost audit requirement for the companies –

- Companies whose revenue from export (in foreign exchange) is more than 75% of its total revenue; or
- Companies who are operating from a special economic zone.

Cost Audit Programme

A Cost 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 cost statements and giving the estimated time required. In other words, Cost audit programme is a coordination of the work to be done, the work distributed among the audit staff and the time within which the assignment has to be completed. The cost auditor has to submit his report to the central government with a copy to the company under audit. His programme must have a systematic plan of action so that it is finished within a stipulated time and at a minimum cost.

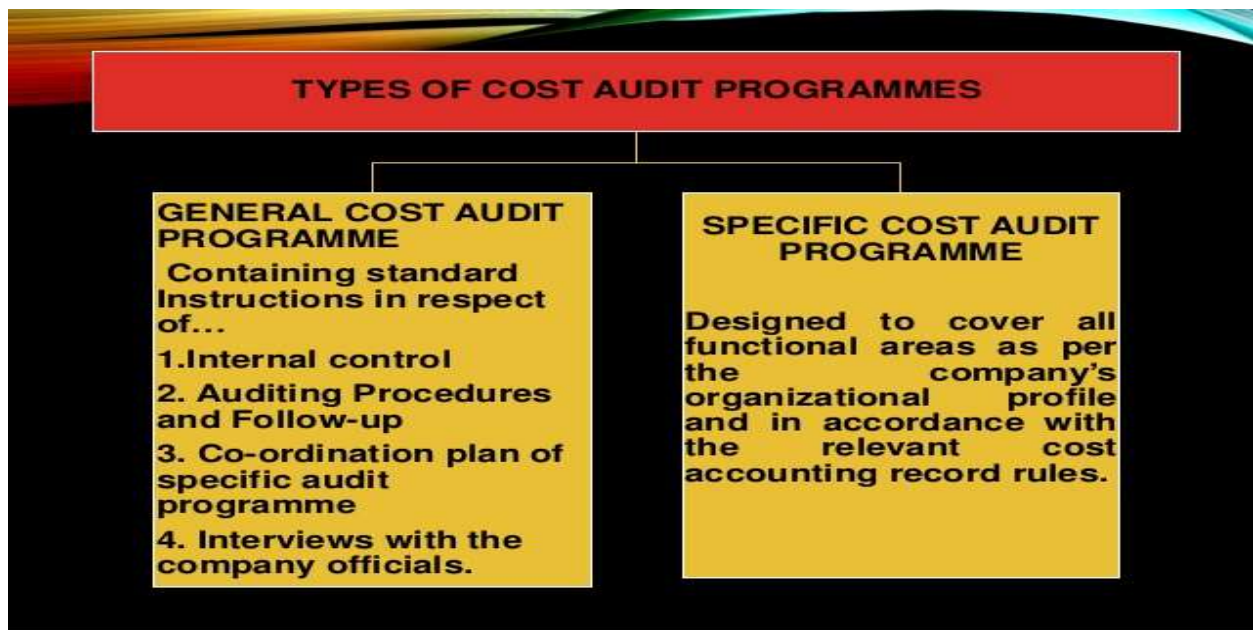
Subject Matter of Cost Audit Programme: Cost audit programme is a detailed plan of-

- Audit work to be performed,
- Procedures to be followed in verification of each item in the cost statements,
- Allocation of work to audit staff, and
- Estimated time duration for the completion of work.

The points which need special attention in the course of cost audit are:

- Date of commencement of commercial production.
- Cost accounting system is in existence and it is adequate.
- Cost of major raw materials consumed both in terms of quantity and value.
- Incentive schemes with particular references for increasing the productivity.
- Method of depreciation adopted by the company.
- Significant variations in the expenditure incurred against overheads as compared with the previous two years.
- Any other feature affecting the production.

Types of Cost Audit Programme: There should be two types of cost audit programme-



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.