

# 1






## ***BASICS OF COST AUDIT***

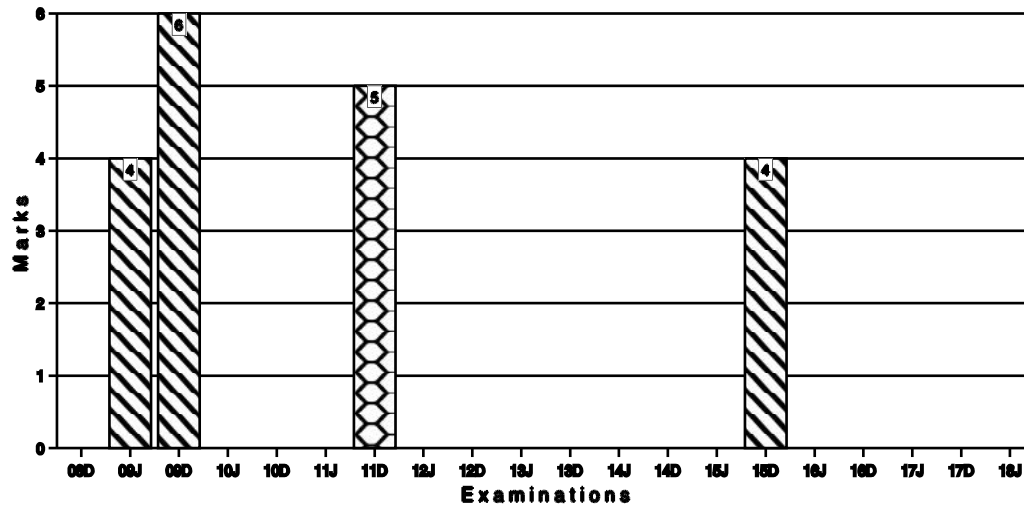
### **THIS CHAPTER INCLUDES**

- Nature of Cost Audit
- Origin of Cost Audit
- Genesis of Cost Audit
- Relevance of Cost Audit
- Objectives of Cost Audit
- Legal Framework of Maintenance of Cost Records and Cost Audit
- Companies (Cost Records and Audit) Rules, 2014

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

### **Legend**

 Objective    Short Notes    Distinguish    Descriptive    Practical



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## CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	<b>Nature of Cost Audit</b>	Cost audit involves an examination of cost books, cost accounts, cost statements and subsidiary and prime documents with a view to satisfying the auditor that these represent true and fair view of the cost of production. This includes the examination of the appropriateness of cost accounting system.
2.	<b>Origin of Cost Audit</b>	In India, methods and techniques of cost accounting and audit of cost accounts can be traced back to pre-independence era when a large number of firms were given contracts by the Government of India on cost plus basis. The Government then started verifying and investigating into the cost structure of such firms. This trend continued on a large scale during World War ii that led to the recognition of cost as a distinct concept not only in India but also in the industrial economies of the world.
3.	<b>Genesis of Cost Audit</b>	In the mid-fifties, famous case of corporate frauds in Dalmia-Jain companies virtually jolted the then Government. It resulted in the government appointing Vivian Bose Commission and later the Dutta Commission and Daphtary-Sastri Committee. These Commissions/ Committees observed inadequacies in the then existing system of financial accounting and audit and also in the then existing system of corporate disclosures. They recommended a more effective system of cost

		accounting and cost audit, to supplement the financial accounting and auditing practices.
4.	<b>Relevance of Cost Audit</b>	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 the Companies Act, 1956 was to meet the government requirements for regulating the price mechanism in some core industries.
5.	<b>Objectives of Cost Audit</b>	<ul style="list-style-type: none"> <li>• Ensuring that the prescribed procedures of cost accounting records rules are duly adhered to.</li> <li>• Detection of errors and fraud.</li> <li>• Verification of the cost of each "cost unit" and "cost center" to ensure that these have been properly ascertained.</li> <li>• Determination of inventory valuation.</li> <li>• Facilitating the fixation of prices of goods and services.</li> <li>• Periodical reconciliation between cost accounts and financial accounts.</li> <li>• Ensuring optimum utilization of human, physical and financial resources of the enterprise.</li> <li>• Detection and correction of abnormal loss of material and time.</li> <li>• Inculcation of cost consciousness.</li> </ul>
6.	<b>Legal Framework of Maintenance of Cost Records and Cost Audit</b>	<ul style="list-style-type: none"> <li>• <b>Section 2(13) of Companies Act, 2013</b>, defines the 'books of accounts' to be maintained by the Companies.</li> <li>• It includes "the items of cost as may be prescribed under Section 148 in the case of a company which belongs to any class of companies specified under that section ;"</li> <li>• <b>Section 128 of Companies Act, 2013</b>, talks</li> </ul>

		<p>about the “Books of account, etc., to be kept by company”,</p> <ul style="list-style-type: none"> <li>• <b>Section 148 of Companies Act, 2013</b>, empowers the “central government to specify audit of items of cost in respect of certain companies” and</li> <li>• <b>Sub-sections (2) to (5) of Section 147 of Companies Act, 2013</b> contain the provision of “Punishment for contravention”</li> <li>• Section 469 which empowers Central Government to make Rules.</li> </ul>
7.	<b>Companies (Cost Records and audit) Rules, 2014</b>	<ul style="list-style-type: none"> <li>• The Companies (Cost Records and Audit) <b>Rules, 2014</b> has categorized the companies into Regulated and Non-regulated Sectors, based on the product(s)/service(s) manufactured / provided by them;</li> <li>• A Company engaged in manufacture/provision of any specified product(s)/service(s) is required to maintain cost Records if its overall turnover exceeds ₹ 35 crores during immediately preceding Financial Year from all it's the products and services;</li> <li>• The Cost records have to be maintained as specified in CRA-1</li> <li>• The Companies, falling under the regulated sectors having overall annual turnover of ₹ 50 crores or more and the aggregate turnover of the individual product(s) or service(s) specified of ₹ 25 crores or more, have to get their Cost Records Audited;</li> </ul>

	<ul style="list-style-type: none"><li>• Six Sectors are brought under the Regulated category, namely, telecommunication services, Power generation, Transmission, Distribution and Supply; Petroleum products; Drugs and Pharmaceuticals; Fertilizers; Sugar and Industrial alcohol;</li><li>• The Companies, falling under the unregulated category viz. Business of plastics and polymers, glass, electrical, textiles, milk powder businesses, etc., having overall annual turnover of ₹ 100 crores or more and the aggregate turnover of the individual products or services specified of ₹ 35 crores or more, have to get their Cost Records Audited;</li></ul>
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## SHORT NOTES

**2011 - Dec [3]** (b) Write a note on 'social objectives' of Cost Audit.

**(5 marks)**

**Answer :**

The following are the social objectives of cost audit:

1. It helps in improving productivity of all the resources employed by the enterprise.
2. It helps in using the resources in most beneficial manner as all the areas are studied by the company.
3. It helps in fixation of reasonable prices of goods and services produced by the concern.
4. It helps in highlighting areas of inefficiency and mismanagement and thus increases the overall profits of the company.
5. It helps in contract costing particularly where the price is subject to escalation due to inflation.

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6. It helps in cost plus contracts where records of cost play a very important role.
7. It also helps the government in setting prices for regulated goods.
8. It acts as an ethical standard.

### **DESCRIPTIVE QUESTIONS**

**2009 - June [4]** (b) Define Cost Audit and state its purposes. **(4 marks)**

**Answer :**

Cost Audit means audit of cost accounting records. According to CIMA London, cost audit is “the verification of the correctness of cost accounts and of the adherence to the cost accounting plan”.

The Institute of Cost Accountant of India on the other hand, defines cost audit as “a system of audit introduced by the Government of India for the review, examination and appraisal of the cost accounting records and attendant information, required to be maintained by specified industries.”

The purpose of cost audit can be understood by the definition itself. In India cost audit is more specific and lays emphasis on the evaluation of the efficiency of operations and the propriety of management actions.

The purpose of cost audit can be summarized by the following points:

1. To ascertain that T&F COP is worked out.
2. To ensure that inefficiencies, bottlenecks etc are resolved.
3. To bring out areas of wastage, possibility of cost control & reduction.
4. To bring out areas of inefficiency, deficiencies etc. and suggest remedial measures.

**2009 - Dec [2]** (a) What are the Social objectives of Cost Audit? **(6 marks)**

**Answer:**

The following are the social objectives of cost audit:

1. Improvement in productivity of all resources of the enterprise.
2. It helps in using the resources in most beneficial manner as all the areas are studied by the company.
3. It helps in fixation of reasonable prices of goods and services produced by the concern.

4. It helps in highlighting areas of inefficiency and mismanagement and thus increases the overall profits of the company.
5. It helps in contract costing particularly where the price is subject to escalation due to inflation.
6. It helps in cost plus contracts where records of cost play a very important role.
7. It also helps the government in setting prices for regulated goods.
8. It acts as an ethical standard.

**2015 - Dec [1]** Answer the question:

- (b) (i) What are the duties of the companies in relation to provisions of Section 148 of the Companies Act, 2013 and Rules framed thereunder? **(4 marks)**

**Answer:**

1. Every company shall appoint a cost auditor within 180 days of Commencement of every financial year.
2. Inform the cost auditor concerned of his appointment.
3. According to Section 148 of Companies Act, 2013 a company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section(2) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

If after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub- section(6), the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by Government.

4. If any default is made in complying with the provisions of this section:
  - (a) The company and every officer of the company who is in default shall be punishable in the manner as provided in sub- section(1) of Section 147.
  - (b) The cost auditor of the company who is in default shall be punishable in the manner as provided in sub-section(2) to (5) of Section 147.