

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. Cost Audit is a methodical and reliable verification of the accounts and records, to maintain the accounts according to the Cost Accounting Standards. The ICWAI (The Institute of Cost Accountant of India) 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*'.

Appointing Authorities of Cost Audit

A cost auditor may be appointed by:

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

(ii) By external authorities such as, by

(a) Government to conduct audit on behalf of Government.

(b) Customer to carry out cost audit on behalf of customer.

(c) Trade association or tribunal to facilitate cost audit on behalf of trade association or tribunal.

Purpose of Cost Audit

The reasons for doing cost audit may be summarised as under:

1. **To Assist Management:** The main purpose of this audit is to give proper, relevant and accurate information to the Management to assist in taking the important decision. In this audit, a report is submitted suggesting certain ways to reduce the cost of production, guidance to the management for increasing the efficiency in the manufacturing unit, any loss making unit and to make the improvement in the accounting plan.
2. **On behalf of Government:** Government may appoint the cost auditor to conduct audit wherever required:
 - a. If the Government feels to carry out the audit as per the Companies Act, 2013
 - b. To analyses the certain amount of cost if the government is approaching certain financial help.
 - c. To fix a certain amount of cost while preparing for the tender.
3. **On behalf of Tribunals:** Labour Tribunals may direct the cost auditor to settle the disputes for more wages, bonuses, shares in profit, etc. The Income tax department may direct the audit of cost account to get the correct profit.

4. **Cost Audit under Statute:** As per the Companies Act, 2013 there are certain classes of Companies that need to carry the audit to get the accounts audited.
5. **Statutory Cost Audit:** As per the statutory rules and Act it is mandatory for the Company to carry out the Audit.

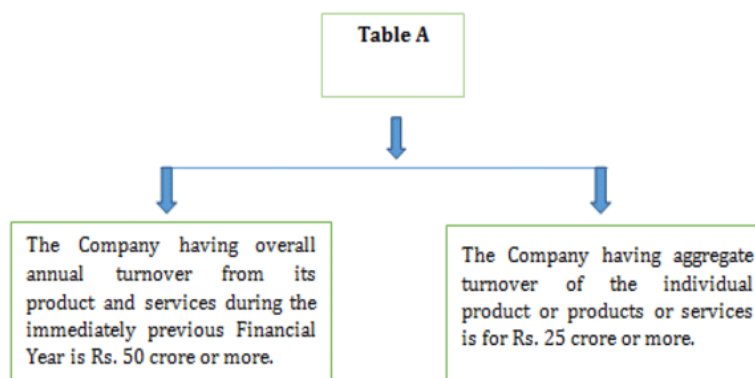
Benefits of Cost Audit in India

- It helps in the detection of errors and fraud.
- Systematically smoothens the work of accounting.
- Brings the Cost of product at the minimum level.
- Helps to maintain the standard budgetary cost.
- Enables the management to take the decision accurately.
- Keep the management aware that the Accounts are prepared according to Cost Accounting standards or not.

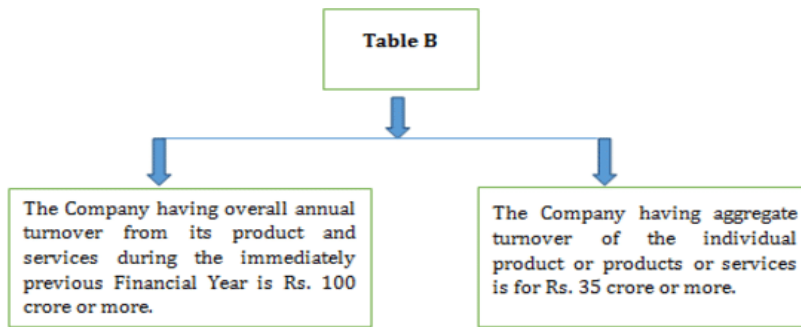
Applicability of Cost Audit under the Companies Act, 2013

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

1. **Regulated Sector** (Table A): It covers the industry like Petroleum products, Drugs and Pharmaceuticals, Fertilisers, Sugar and Industrial alcohol, etc.



2. **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.



Cost Audit shall be applicable to those companies whose products / services falls under the sectors which are mentioned in the tables (Table A – Regulated sectors and Table B – Non-regulated Sectors) to the Companies (Cost Record and Audit) Amendment Rules 2016.

Non Applicability of Cost Audit

The following Companies are not required to conduct the cost audit in India:

1. The Company whose revenue from exports are in Foreign Exchange exceeds 75% of its total revenue.
2. Operating from Special Economic Zone (SEZ).
3. Engaged in the generation of electricity for captive consumption through Captive Generating Plant. The term “Captive Generating Plant” shall have the same meaning as mentioned in rule 3 of the Electricity Rules, 2005.”

Qualifications of Cost Auditor

The Cost Auditor can be appointed from the following persons.

- (i) Any person who is According to Cost and Works Accountant Act is a Cost Accountant.
- (ii) Any person who is a Chartered Accountants according to Chartered Accountant Act and is a practicing Chartered Accountant.
- (iii) He should be a member of Institute of Chartered Accountant.
- (iv) He should be a fellow of 10 years standing.
- (v) He should be practicing while appointed as Cost Accountant.

Disqualifications

The main disqualifications are:

- (i) A person cannot be appointed as Cost Auditor who according to Company’s Act 1956 U/S 226 is not competent to be appointed as Cost Auditor.
- (ii) Any person who is appointed as Auditor of a company cannot be appointed as Cost Auditor of the same company.
- (iii) Any person who becomes incompetent after his appointment as Cost Auditor he should stop working as cost Auditor since that date.

Scope of Cost Audit

The scope of cost audit has two important aspects:

- (i) Propriety Audit.
- (ii) Efficiency Audit.

Propriety Audit

This aspect of audit is concerned with actions and plans of management which 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 has to ensure that the item of expenditure is proper and reasonable on the grounds of propriety.

Thus, the cost auditor has to report:

- (a) Whether or not the planned expenditure could give optimum results.
- (b) Whether or not the size or channels of investment were designed to produce the best results.
- (c) Whether the return from investment in certain channels could be bettered by some alternative plan of action.

Efficiency Audit

This aspect of cost audit is concerned with the evaluation of performances. It covers the *verification of the facts that the expenditure has been incurred according to the plan and the results obtained have also been according to the plan*. It covers the examination of the plan prepared in the form of budgets (financial and functional) and the comparison of the actual performance with the budgeted performance and analysing the reasons for variances.

Thus, the efficiency audit ensures that:

- (a) every rupee invested in capital or in other fields gives the optimum return; and
- (b) investment in different spheres of the business has been so balanced that it gives maximum results.

Submission of Cost Audit Report

A cost auditor is required to submit his audit report along with his/ her qualifications, reservations, observations or suggestions if any, in form CRA-3 to Board of Directors of the Company within 180 days from the closure of financial year to which the report relates. The Audit Report shall be filed with the Central Government within 30 days from the date of receipt of the Audit Report.

Penalty for Non-Compliance

Any non-compliance made under this Audit, the Company and every officer of the Company who is in default shall be punishable as mentioned under:

1. Company shall be punishable with fine which shall not be less than rupees twenty five thousand but it may extend to rupees five lacs and

2. Every officer of the Company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than rupees ten thousand but it may extend to rupees one lacs or both
3. If the Cost Auditor has contravened the provisions, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than rupees fifty thousand but it may extend to rupees twenty five lacs or eight times the remuneration of the Cost Auditor, whichever is less.

Disclaimer:

1. These notes are only for the students.
2. These notes are prepared after referring various books and websites.