

13

C H A P T E R

COST AUDIT

Meaning

13.1 Cost audit means an examination of cost records. It has been defined as "the verification of the correctness of cost accounts and of adherence to the cost accounting plan". Cost audit is undertaken with the broad objective of ascertaining whether cost accounts present a true and fair view of the cost of production or manufactured products dealt with by the enterprise under audit.

Objectives of cost audit

13.2 The objectives of cost audit can be grouped under two heads—

- General objectives

- Social objectives

(i) **General objectives :**

- (a) Verification of cost accounts in order to ascertain whether they have been properly maintained according to the principles of costing employed in the industry concerned.
- (b) Detection and prevention of frauds and errors.
- (c) Verification of cost of each "cost unit" and "cost centre" to ensure that these have been properly ascertained.
- (d) Assisting management to fix the prices of goods and services; to identify wastage in the use of material and time; to review the working of costing system installed by management and to advise management on any other important matter.

(ii) **Social objectives :**

- (a) Ensuring optimum utilisation of resources by preventing wastage or misuse of resources. It further leads to improvement in productivity of these resources.
- (b) Determination of fair prices.
- (c) Protecting the interest of various parties such as the Government (for settlement of tax liability) and shareholders (for optimum use of resources which leads to capital appreciation).

Importance of cost audit

13.3 During the last century, cost audit has assumed much importance for the companies engaged in manufacturing, mining, etc. Different groups of persons associated with the enterprise recognise the need for cost audit because of the advantages associated with it. Some of these are listed below :

(i) For management -

- (a) Determination and allocation of cost of products.
- (b) Helps to identify wastage, inconsistency and irregularity in production and, thus, take corrective measures.
- (c) Ensures that the cost accounts have been maintained in accordance with the principles of the costing employed in the industry concerned.
- (d) Serves as a basis for making important decisions such as discontinuing a particular product, make or buy an input, etc.
- (e) Helps in proper valuation of inventory.

(ii) For shareholders -

- (a) Serves as a measure to determine the managerial efficiency or otherwise.
- (b) Serves as a tool to know whether resources are being properly utilised. Optimum utilisation of resources would lead to wealth appreciation.

(iii) For the Government -

- (a) Provides reliable data to the Government for deciding whether to offer any subsidy or extend tariff protection to a particular industry.
- (b) Helps to tax the prices of commodities under a scheme of price control.
- (c) Helps to curb profiteering in case of scarce goods.
- (d) Serves as a basis to charge tax on the cost of finished goods.

(iv) Miscellaneous

- (a) Facilitates settlement of industrial disputes.
- (b) Ensures that consumers get the product at fair price.
- (c) Helps the association of various industries to compile standard costs against which individual firms may compare their actual cost figures.

Keeping into consideration various advantages associated with cost audit, the Government of India inserted section 233B in the Companies Act, 1956 by the Companies (Amendment) Act, 1965 to provide for statutory cost audit in case of specified companies.

Provisions regarding cost audit under the Companies Act, 2013

13.4-1 Provisions under the Companies Act

Section 148 of the Companies Act, 2013 contain provisions with regard to cost audit. These can be summarised as under :

Relationship between cost audit and financial audit

13.5 Cost audit and financial audit are similar in various aspects - both analyse the financial aspect of transactions of the organisation; both are required to be undertaken by persons having special knowledge; recognised accounting principles and standard auditing practices are to be adhered to by both and so on. Despite these similarities, few points of distinction exist between the two—

- (i) **Statutory status** - Financial audit has been made *compulsory* for *limited companies* by the Companies Act, 2013. But cost audit is *not compulsory* except in certain cases of limited companies.
- (ii) **Object** - The main object of financial audit is to ascertain *a true and fair view of the state of affairs and working results* of a business. On the other hand, the broad object of cost audit is to *ascertain whether cost accounts present a true and fair view of the cost of production of products* dealt with by the enterprise under audit.
- (iii) **Regularity** - Statutory financial audit is conducted *every year*. But cost audit is to be conducted only *if the Central Government makes an order* for a particular year and for the company specified under such order. Usually, in practice, wherever the Central Government orders the cost audit, it requires the companies concerned to get the audit done every year till further orders. Thus, cost audit is not conducted for all years.
- (iv) **Relationship with transactions** - Financial audit involves the collection and evaluation of evidence to *substantiate the transactions* recorded in the books of account. On the other hand, cost audit aims at *determining the propriety and efficiency* of business transactions.
- (v) **Verification of stock** - In financial audit, an auditor ensures that the closing stock has been *properly shown and valued for the purpose of balance sheet*. The cost auditor, on the other hand, has to *assess the adequacy or otherwise* of the level of the stock *in accordance with the need of the enterprise*.
- (vi) **Appointment of auditor** - The financial auditor is appointed *by the shareholders* in general meeting. In some cases, however, he may be appointed by *board of directors* (first auditors and auditors appointed to fill casual vacancy except one arising because of resignation of the auditor); *and the Comptroller and Auditor General of India (CAG)* (in case of Government companies). But cost auditor is always appointed by the *board of directors*.
- (vii) **Submission of report** - Unlike financial audit, the report of the cost auditor is made to the BOD and not to the shareholders of the company. A *copy* of cost audit report is sent *to the Central Government* by the BOD.