PROCEDURE FOR APPOINTMENT OF COST AUDITOR

INTRODUCTION

In order to assess the productivity of some important industries which had direct bearing on supply management system for the growth of Indian Economy and as a service to the Cost Accounting Records under Section 209 (1) (d) and Section 233(B) of the Companies Act, 1956 came in to force. The real beginning of the Cost Audit, however, started in 1965 when the Companies Act, 1956 was amended to incorporate the provisions relating to the maintenance of Cost Accounting Records and Cost Audit. Such amendments were made on the basis of recommendations received from Vivian Bose Commission, Dutta Commission and Shastry Commission.

DEFINITION OF COST AUDIT

Cost Audit would apparently mean an examination of cost books, cost accounts, cost statements and subsidiary and prime documents with a view to satisfying the auditor that the available records represents fair and true view of the cost of production of enterprises.

"Cost Audit is the verification of cost accounts and check on the adherence to the cost accounting plan" (I.C. M.A. London). "By the term 'Cost Audit' it means the detailed checking of the costing system, technique and accounts to verify their correctness and to ensure adherence to the objective of cost accounting" (Smith & Day).

According to the Institute of Cost and Works Accountants of India (ICWAI) Cost Audit is 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.

STATUTORY REQUIREMENT FOR COST AUDIT

Section 209(1) (d) provides that a company pertaining to any class of companies engaged in the production, processing, manufacturing or mining activities, should keep proper books of account showing such particulars relating to utilization of material and labor or to other items of cost as may be prescribed, if such class of companies is required by the Central Government to include such particulars in the books of account.

In pursuance of the provisions of section 209(1) (d) of the Act, the Central Government has notified Cost Accounting Records Rules for a number of specified industries with a view to ensuring that the records so maintained highlights the area of inefficiencies or high cost.

When a company is required to include in its books of account the aforesaid particulars, section 233B empower the Central Government to direct, whenever it is necessary to do so, that an audit of cost accounts of the company should be conducted in such manner as may be specified in the order by a Cost Accountant within the meaning of Cost and Works Accountants Act, 1959.

The Cost Auditor will be appointed by the Board of Directors of the Company in accordance with the provisions of section 224(1B) and with the previous approval of the Central Government for the financial year and not by the company in General Meeting.

PROCEDURE FOR APPOINTMENT/RE-APPOINTMENT OF COST AUDITORS

Ministry has reviewed the existing procedure followed by the companies seeking prior approval of the Central Government for appointment of cost auditor under section 233B(2) of the Companies Act, 1956 vide General Circular No. 15/2011 dated April 11, 2011. In supersession of any earlier order/circular issued in this regard, the revised procedure to be followed by the Companies for appointment of a Cost Auditor shall be as under:

(a) The company required to get its cost audited under section 233(B)1 of the Companies Act, 1956 shall appoint a cost auditor who is a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Work Accountant Act, 1959 and who hold a valid certificate of practice under sub-section (1) of section 6 of the said Act and includes a firm of cost accountants.

(b) The Audit Committee of the Board shall be the first point of reference regarding the appointment of cost auditors.

(c) The Audit Committee shall ensure that the cost auditor is free from any disqualifications as specified under section 233B(5) read with section 224 and sub-section (3) or sub-section (4) of section 226 of the Companies Act, 1956.

(d) While a Cost Auditor shall have the prime responsibility to ensure that he does not violate the limit specified under section 224(1-B) of the Companies Act, 1956, the Audit Committee shall also be responsible for such compliance by the cost auditor.

(e) The Audit Committee shall obtain a certificate from the cost auditor certifying his/its independence and arm's length relationship with the company.

(f) The Company shall e-file its application with the Central Government on www.mca.gov.in portal, in the prescribed Form-23C within 90 days from the date of commencement of each financial year, along with the prescribed fee and other documents as per existing practice *i.e.*

(1) Certified copy of Board Resolution proposing appointment of the cost auditor; and (Annexure-I)

(2) Copy of Certificate obtained from the Cost Auditor regarding compliance of section 224(1B) of the Companies Act, 1956 (Annexure-II)

(g) On filing of application, the same shall be deemed to be approved by the Central Government, unless contrary is heard within 30 days from the date of filing of such application.

(h) If within 30 days from the date of filing of such application, the Central Government directs the company to re-submit the said application with such additional information or explanation, as may be specified in that direction, the period of30 days for deemed approval of the Central Government shall be counted from the date of re-submission by the company.

(i) After the expiry of 30 days, as the case may be, the company shall issue formal letter of appointment to the cost auditor, as approved by the Board.

(j) Within 30 days of receipt of formal letter of appointment from the company, the cost auditor shall inform the Central Government in the prescribed Form-23D, along with a copy of such appointment.

(k) The Company shall disclose full particulars of the cost auditor, along with the due date and actual date of filing of the cost audit report by the cost auditor, in its Annual Report for each financial year.

(l) In those companies where constitution of an "Audit Committee" of the Board is not required by law, the words "Audit Committee" shall stand substituted by the words "Board of Directors".

The cost auditor has the same powers and duties in relation to the audit of cost accounts, as are provided for statutory auditor under section 227 of the Companies Act, 1956. His remunerations is fixed by the Board of Directors of the Company.

APPOINTMENT OF CHARTERED ACCOUNTANT AS COST AUDITOR

Generally, the Central Government may, by order, direct that an audit of cost accounts of the company shall be conducted in such manner as may be specified in the order by an auditor who shall be a Cost Accountant within the meaning of the Cost and Work Accountants Act, 1959.

However, if the Central Government is of the opinion that sufficient number of qualified cost accountants are not available for conducting the cost audit, the Central Government may, by gazette notification direct that for such period as may be specified in the said notification, such chartered accountants may also conduct and audit of cost accounts of companies and thereupon a chartered accountant may be appointed to audit the cost accounts of the company.

CERTAIN CATEGORY OF PERSONS NOT QUALIFIED FOR APPOINTMENT AS AUDITOR

1. Section 226(3) and (4) of the Companies Act, 1956 states that none of the following persons shall be qualified for appointment as cost auditor of a company:—

(*a*) a body corporate;

(*b*) an officer or employee of the company;

(*c*) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(*d*) 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 exceeding one thousand rupees;

(*e*) a person holding any security of that company after a period of one year from the date of commencement of the Companies (Amendment) Act, 2000 *i.e.* 13th December, 2000;

(*f*) For the purposes of section 226, "security" means an instrument, which carries voting rights;

(*g*) a person if he is, by virtue of section 226(3), disqualified for appointment as auditor of any other body corporate which is that company's subsidiary or holding company or subsidiary of that company's holding company. [Section 226(4)]

Circular No. 8/1/57-PR, dated 11-7-1957 provides that the Government have examined the question whether on his engagement as the income-tax consultant of a company either on payment of *ad hoc* fee or fees plus retainer or on fixed periodical remuneration, then he will be regarded as an officer or employee of the company for the purpose of section 226(3)(*b*) of the Act, and consequently as being disqualified for appointment as an auditor of the company.

2. A person appointed under section 224 as an auditor of a company, shall not be appointed or re-appointed for conducting the audit of cost accounts of the company.

3. If a person, appointed for conducting the audit of cost accounts of a company, becomes subject, after his appointment, to any of the disqualifications specified in clause (a) or clause (b) of section 233B (5), he/she shall on and from the date on which he become so subject, cease to conducted the audit of the cost accounts of the company.

4. No relative of a director of firm or partner of such relative can be appointed cost auditor of the company except with the previous approval of the Central Government when the company has a paid-up capital of rupees one crore or more (Proviso to Section 297(1) of the Companies Act, 1956).

INTERNAL AUDITOR WILL NOT APPOINT AS COST AUDITOR

Circular No. 1/83, dated 20.01.1983 states that a question has now been raised whether a cost auditor of a company can also be its internal auditor, which has been carefully examined in this Department. Since the cost auditor is required to comment on scope and performance of internal auditor as per the provisions of the Cost Audit (Reports) Rules, 1968. The Department is, therefore of the view that the cost auditor should not also be the internal auditor of a company during the period appointed for conducting the cost audit.

PARTICIPATION IN AUDIT COMMITTEE MEETINGS

A Cost Auditor wherever appointed should be invited to the audit committee and should also attend and participate at the meeting of audit committee but shall not have right to vote. His presence in audit committee meeting should be as an auditor and not and not as a member. *{General Circular No.2 of 2005 dated 09.01.2005 read with Circular No. 6 of 2001 dated 20.08.2001}*.

PROCEDDING OF COST AUDIT

There are following procedure to be followed by the cost auditor after appointment as auditor of the company:

(1) Every cost auditor, who conducts an audit of the cost records of the company, shall submit the report (a hard copy and a soft copy) along with auditor's observations and suggestions, and Annexure to the Central Government in the prescribed Form II and at the same time forward a copy of such report to the company.

(2) The cost audit report submitted on or after 1st day of April, 2012, irrespective of the financial year of the company to which it relates, shall be in the form prescribed under these rules.

(3) Every company as specified in sub-rule (1) of rule 3 of the Companies (Cost Audit Report) Rules, 2011 shall, keep and maintain cost details, statements, schedules, etc. for each unit and each product or activity comprised in each product group, duly authenticated by at least two Directors of the company and the cost auditor.

(4) The cost details, statements, schedules, etc. of every company, as specified in sub-rule (3), relating to a period of not less than eight financial years immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years shall be kept in good order:

(5) Every cost auditor, who submits a report under sub-rule (1) of Rule 4 of the Companies (Cost Audit Report) Rules, 2011, shall also furnish performance appraisal report, duly authenticated by the cost auditor, to the Board/Audit Committee of the company in the prescribed Form III.

(6) Every cost auditor, who submits a report under sub-rule (1) of Rule 4 of the Companies (Cost Audit Report) Rules, 2011, shall also give clarifications, if any, required by the Central Government on the cost audit report submitted by him, within thirty days of the receipt of the communication addressed to him calling for such clarifications.

(7) Every cost auditor shall forward his report referred to in sub-rule (1) of rule 4 to the Central Government and to the concerned company within one hundred and eighty days from the close of the company's financial year to which the report relates in prescribed form.

(8) After receiving report from Cost Auditor under sub-rule (1) of Rule 4 of the Companies (Cost Audit Report) Rules, 2011, the Company will file the same report in prescriber new e-Form I electronically through www.mca.gov.in portal with Central Government within 30 days from receiving.

(9) Without prejudice to the powers and duties the Cost Auditor shall have under sub-section (4) of section 233B of the Act, the company and every officer thereof, including the persons referred to in sub-section (6) of section 209 of the Act, shall make available to the cost auditor, such cost accounting records, cost statements, other books and documents, and Annexure to the Report, duly completed, as would be required for conducting the cost audit, and shall render necessary assistance to the cost auditor so as to enable him to complete the cost audit and submit his report within 180days.from the end of financial year of the company.

(10) The Annexure prescribed with the cost audit report shall be approved by the Board of Directors before submitting the same to the Central Government by the cost auditor. The Annexure, duly audited by the cost auditor, shall also be signed by the Company Secretary and at least one Director on behalf of the company. In the absence of Company Secretary in the company, the same shall be signed by at least two Directors.

(11) The Central Government may, after considering the report and information and explanations furnished by the company, take such action on the report as it may consider necessary. The Central Government may direct the company to circulate the whole or a specified portion of the report with the notice of next annual general meeting.

PENALITIES

As per General Circular No. 15/2011, dated 11.04.2011, if a company contravenes any provisions of this circular (procedure for appointment of cost auditor), the company and every officer thereof who is in default, including the persons referred to in sub-section (6) of section 209 of the Companies Act, 1956 shall **be punishable as provided under sub section (2)** of section 642 read with sub-section (5) and (7) of section 209 and sub-section(11) of section 233B of the Companies Act, 1956.

Relevant provisions of non compliance by the company under Companies Act, 1956 are as follow:

Sub section (5) of section 209 provides that if any of the persons referred to in sub-section (6) fails to take all reasonable step to secure compliance by the company with the requirements of this section, or has by his own willful act been the cause of any default by the company there under, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to ten thousand rupees, or with both:

Provided that in any proceedings against a person in respect of an offence under this section consisting of a failure to take reasonable steps to secure compliance by the company with the requirements of this section, it shall be a defense to prove that a competent and reliable person was charged with the duty of seeking that those requirements were complied with and was in a position to discharge that duty:

Provided further that no person shall be sentenced to imprisonment for any such offence unless it was committed willfully.

Sub- section (6) of Section 209 provides that the persons referred to in subsection (5) are the following, namely:—

(a) where the company has a managing director or manager, such managing director or manager and all officers and other employees of the company; and

(b) where the company has neither a managing director nor manager, every director of the company;

Sub- section (7) of Section 209 provides that if any person, not being a person referred to in sub-section (6), having been charged by the managing director, manager or Board of directors, as the case may be, with the duty of seeing that the requirements of this section are complied with makes default in doing so, he shall, in respect of each offence, be punishable with imprisonment for a term which my extend to six months, or with fine which may extend to ten thousand rupees, or with both.

RELEVANT PROVISION OF SECTION 642 OF THE COMPANIES ACT 1956 IS AS UNDER:

Sub-section (2) of Section 642 provides that any rule made under sub-section (1) may provide that a contravention thereof shall be punishable with fine which may extend to five thousand rupees and where the contravention is a continuing one, with a further fine which may extend to five hundred rupees for every day after the first during which such contravention continues.

NON COMPLIANCE BY COST AUDITOR

If default is made by the cost auditor in complying with the aforesaid provisions, he/she shall be punishable with fine which may be extended to Rs. 5000/-.

(**NOTE:** This information is given for the limited purpose of bringing awareness about the subject matter for readers.)

THANK YOU

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