COST AUDIT & COST RECORD

Basic Abstraction:

Cost audit is the independent audit of cost records maintained by companies. The concept of cost audit was introduced in 1965 when Companies Act, 1956 was amended to incorporate the provisions relating to the maintenance of cost accounting records and cost audit. Cost audit got an impetus in 2011 when its scope was expanded and the rules and reporting formats were simplified to address industry concern of confidentiality.

The Companies Act, 2013 has retained the provisions relating to maintenance of cost records and cost audit. The Ministry of Corporate Affairs notified the Companies (Cost Records and Audit) Rules 2014 on June 30, 2014.

The new Rules mandate the maintenance of cost records in companies engaged in:

→ the production of specified goods in strategic sectors,

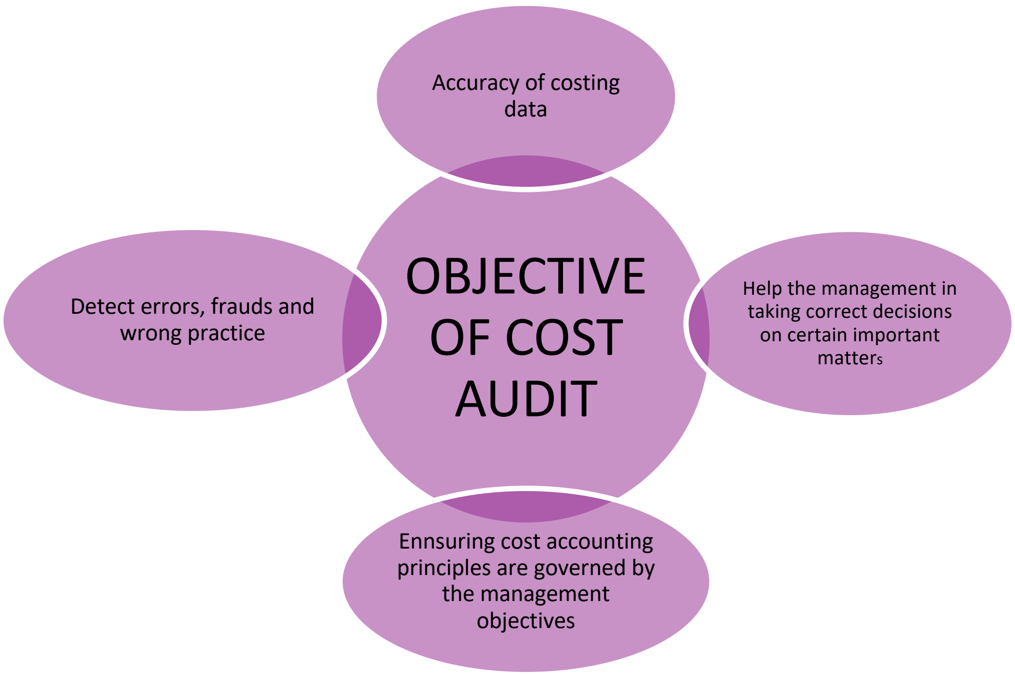
→ Companies engaged in an industry regulated by a sectoral regulator or a Ministry or Department of Central Government,

→ Companies operating in specified areas of public interest

→ Companies engaged in the production, import and supply or trading of specified medical devices.

- *The Rules also provide for a threshold in terms of* ***net worth or turnover of companies****, thus, Restricting its applicability to the large companies.*
- *The Government has mandated maintenance of cost records and cost audit only in those sectors, which might require policy intervention.*
- *For the first time, it has brought construction companies, companies engaged in health services and companies engaged in education services within the ambit of cost audit. The Government has categorised those as companies operating in the area of public interest.*
- *The government has excluded the industries in which the competition among companies is significant. Presumably, the Government has taken the view that cost audit is not relevant in companies that operate in a competitive environment.*

Companies Act, 2013 aims to strengthen corporate governance by empowering the Board of Directors. It requires Independent Directors to get involved in critical decisions. They have been made responsible for strategy review, risk management, performance evaluation and key appointments. All these require analyses of cost and revenue data. If, we agree that managers are inherently opportunistic, the Board of Directors needs an assurance from an Independent agency about the integrity of cost and revenue information that is placed before it. Only cost audit by an independent cost auditor can provide that assurance.



- Reliable cost data for managerial decisions
- Reduces the cost of production through plugging loopholes relating to wastage of material, labour and overheads
- Improves efficiency of the organization as a whole and costing system in particular by constant review, revision and checking or routine procedures and methods
- Enables comparison among different units of the factory in order to find out the profitability of the different units
- Fix the responsibility of an individual wherever irregularities or wastage are found
- Assists the 'Tariff Board' in deciding whether tariff protection should be extended to a particular industry or not
- Reliable data to the government for fixing up the setting prices of the various commodities
- Ensures proper records are maintained as to purchases, utilization of materials and expenses incurred on various items i.e wages and overheads etc. It also makes sure that the industrial unit has been working efficiently and economically
- Improves the efficiency of industrial units and thereby assists in economic progress of the nation.

Earlier Section 233B of the Companies Act, 1956:

- 23C- Appointment of Cost Auditor
- 23D for intimation by cost auditor to Central Government

Under companies Act, 2013:

- *Section 148 read with Companies (Cost Record and Audit) Rules, 2014. Notified on 30th june,2014*
- *1st amendment to the rules on 31st December,2014 (The Amendment Rules has introduced certain changes to the original Rules issued on June 30, 2014).*
- *2nd amendment dated 12th June,2015 as Companies (Cost Record and Audit) Amendment,Rules,2015- new form CRA-2(form for intimation of appointment of cost auditor by the company to central government) and form CRA-4 (form for filling cost audit report with the Central Government)*
- *3rd Amendment dated 14th July,2016 as Companies (Cost Record and Audit) Amendment,Rules,2016 (Definition of Cost Audit Report was changed*
- *Companies (cost records and audit) Amendment Rules,2017(Form CRA-1 and CRA-3)*
- *Companies (cost records and audit) Second Amendment Rules,2017(Definition of Custom Tariff Act Heading).*

Section 148 of the Companies Act, 2013:

Central Government to specify audit of items of cost in respect of certain companies:

(1) The Central Government may, by order, in respect of **such class of companies** *engaged in the production of such goods* or *providing such services as may be prescribed*, direct that particulars relating to the utilization of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies:

Provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

(2) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the ***audit of cost records of class of companies, which are covered under sub-section (1)*** and which ***have a net worth of such amount as may be prescribed*** or a ***turnover of such amount as may be prescribed***, shall be conducted in the manner specified in the order.

(3) The audit under sub-section (*2*) shall be conducted by a Cost Accountant in practice who ***shall be appointed by the Board*** on *such remuneration as may be determined by the members* in such manner as may be prescribed:

Provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records:

Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards.

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.

(*5*) 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 that Government.

"Cost audit report" *means the duly signed cost auditor's report on the cost records examined and the cost statements which are prepared as per these rules including attachments, annexure, qualification or observations attached with or included in such report."*

Cost record means books of account relating to utilisation of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in section 148 of the Act and these rules;

Customs Tariff Act Heading" means the heading as referred to in the Additional notes in the First Schedule to the Central Excise Tariff Act,1985.(Notified on 31st December, 2014)

Applicability of cost records.—

For the purpose of sub-section (1) of section 148 of the Act, the class of companies, including Foreign Companies defined in sub-section (42) of section 2 of the Act, engaged in the production of the goods or providing services, specified in Table (Annexure-1) having an ***overall turnover from all its products and services of rupees thirty five crore or more during the immediately preceding financial year***, shall include cost records for such products or services in their books of accounts namely:

Maintenance of Cost Records.-

Every company under these rules including all units and branches thereof, shall, in respect of each of its financial year commencing on or after the 1st day of April, 2014, maintain cost records in **form CRA-1**.

Provided that in case of company covered ***in serial number 12 and serial number 24 to 32 of item (B) of rule 3****,the requirement under this rule shall apply in respect of each of its financial year commencing on or after 1st day of April,2015.*

- ***The cost records referred to in sub-rule (1) shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.***

The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilisation of resources and these records shall also provide necessary data which is required to be furnished under these rules.

Applicability for Cost Audit.-

Every Company specified in i***tem (A)*** of Rule 3 shall get its cost records audited in accordance with these rules ***if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is Rupees fifty crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under Rule 3 is rupees twenry five crore or more.***

Every Company specified i**n item (B)** of Rule 3 shall get its cost records audited in accordance with these rules ***if the overall annual turnover of the Company from all its products and services during the immediately preceding financial year is Rupees One hundred crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained under rule 3 is rupees thirty five crore or more.***

- **The requirement for cost audit under these rules shall not apply to a company which is covered in rule 3,and-**

(i) whose revenue from exports, in foreign exchange, exceeds seventy five percent of its total revenue;or

(ii) which is operating from a special economic zone;

(iii)which is engaged in generation of electricity for captive consumption through Captive Generating PIant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005";

COST AUDIT

Category of companies specified in Rule 3 and the thresholds limits laid down in Rule 4, shall ***within one hundred and eighty days of the commencement of every financial year, appoint a cost auditor***.

"Provided that before such appointment is made, the written consent of the cost auditor to such appointment, and a certificate from him or it, as provided in sub-rule (1.A), shall be obtained";

Cost Auditor appointed under sub-rule(1) shall submit a certificate that

1. The individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Cost and Works Accountants Act, 1959 (23 of 1959) and the rules or regulations made thereunder;

2. The individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Act, so far as may be applicable;

3. The proposed appointment is within the limits laid down by or under the authority of the Act; and

4. The list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.";

- The Company to *file* e- **form CRA-2** *with the Central Government* ***within a period of thirty days of the Board meeting*** *in which* cost auditor is appointed *or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier*, through electronic mode.

- Any **casual vacancy** in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of *Directors within thirty days of occurrence of such vacancy and the* company shall file ***e- Form CRA-2 within thirty days*** of such appointment of cost auditor.

- Every cost auditor, who conducts an audit of the cost records of a company, ***shall submit the cost audit report*** along with his or its reservations or qualifications or observations or suggestions, if any, in **form CRA-3**.

- Every company covered shall ***within a period of thirty days from the date of receipt of a copy of the cost audit report,*** furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in **e-Form CRA-4** in ***Extensible Business Reporting Language format*** in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015.".

- ***The provisions of sub-section (12) of section 143 of the Act and the relevant rules made thereunder shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.***

Cost audit has not lost relevance, even for companies operating in a competitive environment. Benefits from cost audit outweigh its cost. If a company is already maintaining cost records, the incremental cost is the audit fee. The cost of regular staff, which support the audit, is fixed in nature. Therefore, while the cost is immaterial, benefits in terms of improved corporate governance are immense, may not be from the management's perspective.

By introducing the concept of 'public interest', which is difficult to define, the government has made the 2014 Rules unnecessarily complicated and difficult to implement. Rules should be transparent and simple. The current Rules provides the scope for jockeying for inclusion and exclusion of companies from the ambit of cost audit. The government should bring all companies, except small companies, within the ambit of cost audit. It is also important that the cost accounting profession quickly upgrades skills in developing costing systems for emerging businesses, including those in the service sector.

Annexure-"A"

Cost Record Applicability Table

(A) Regulated Sectors:

S. No	Industry/ Sector/Product/Service	Customs Tariff Act Heading (wherever applicable)
1.	Telecommunication services made available to the users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature and regulated by the Telecom Regulatory Authority of India Act 1997 (24 0f 1997); including activities that require authorization or license issued by the Department of Telecommunications, Government of India under Indian Telegraph Act , 1885 (13 of 1885);	Not Applicable
2.	Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003 (36 of 2003);	Generation-2716; Other Activity Not Applicable
3.	Petroleum products; including activities regulated by the Petroleum and Natural Gas regulatory Board under the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006);	2709 to 2715; Other Activity Not Applicable
4.	Drugs and Pharmaceuticals;	2901 to 2942; 3001 to 3105.
5.	Fertilizers;	3102 to 3105.
6.	Sugar and Industrials alcohol;	1701; 1703; 2207.

(B) Non-regulated sectors:

S. No	Industry/Sector/Product/Service	Customs Tariff Act Heading (wherever applicable)
1	Machinery and Mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items; Explanation.-For the purpose of this sub-clause, any company which is engaged in any item or items supplied exclusively for use under this clause, shall be deemed to be covered under these rules	8401;8801 to 8805; 8901 to 8908
2	Turbo jets and turbo propellers;	8411
3	Arms, ammunitions and explosives;	3601 to 3603; 9301 to 9306
4	Propellant powder; prepared explosives (other than propellant powders); safety fuses; detonating fuses; percussion or detonating caps; igniters; electric detonators;	3601 to 3603
5	Radar apparatus, radio navigational aid apparatus and radio remote control apparatus;	8526
6	Tanks and other armoured fighting vehicles, motorised, whether or not fitted with weapons and parts of such vehicles, that are funded (investment made in the company) to the extent of ninety percent or more by the Government or Government agencies;	8710
7	Port services of stevedoring, pilotage, hauling, mooring, re-mooring, hooking measuring, loading and unloading services rendered for a Port in relation to a vessel or goods regulated by the Tariff Authority for Major Ports under the Major Port Trusts Act, 1963 (38 of 1963)];	Not Applicable
8	Aeronautical services of air traffic management, aircraft operations, grounds safety services, grounds handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports	Not Applicable

	Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008(27 of 2008);	
9	Iron And Steel;	7201 to 7229;7301 to 7326
10	Roads and other infrastructure projects corresponding to para No. (1) (a) as specified in Schedule VI of the Companies Act, 2013 (18 of 2013);	Not Applicable
11	Rubber and allied products; including products regulated by the Rubber Board constituted under the Rubber Act, 1947 (XXIV of 1947);	4001 to 4017
12	Coffee and Tea;	0901 to 0902
13	Railway or tramway locomotives, rolling stock, Railway or tramway fixtures and fittings, mechanical (including electro mechanical) traffic signaling equipment's of all kind;	8601 to 8609.
14	Cement;	2523; 6811 to 6812
15	Ores and Mineral products;	2502 to 2522; 2524 to 2526: 2528 to 2530; 2601 to 2617
16	Minerals fuels(other than petroleum),minerals oils etc.:	2701 to 2708
17	Base Metals;	7401 to 7403; 7405 to 7 473; 7419;7507 to 7508; 7601 to 7674; 7801 to 7802; 1804; 7806; 7901 to 7905; 7907; 8001; 8003; 8007; 8101 to 8113.
18	Inorganic Chemicals, organic or inorganic compounds of precious metals, rare-earth metals of radioactive elements or isotopes, and organic Chemicals;	2801 to 2853; 2901. to 2942; 3801 to 3807; 3402 to 3403; 3809 to 3824
19	Jute and Jute Products;	5303, 5307,5310
20	Edible oil;	1507 to 1518
21	Construction Industry as per para No. (5) (a) as specified in schedule VI of the Companies Act,2013 (18 of 2013)	Not Applicable
22	Health services, namely functioning as or running hospitals, diagnostic centers, clinical centers or test laboratories;	Not Applicable
23	Education services, other than such similar services falling under philanthropy or as part of social spend which do not form part of any business;	Not Applicable
24	Milk Powder:	0402
25	Insecticides;	3808
26	Plastics and polymers;	3901 to 3914:3916 to 3921; 3925
27	Tyres and tubes;	4011 to 4013
28	Pulp and Papers	4701 to 4704, 4801 to 4802.
29	Textiles;	5004 to 5007; 5106 to 5113; 52OS to 521,2; 5303; 5307;5310; 5401 to 5408;5501 to 5516
30	Glass;	7003 to 7008; 7011;7016
31	Other machinery and Mechanical Appliances;	8402 to 8487
32	Electricals or electronic machinery;	8501 to 8507: 8511 to 8512: 8514 to 8515; 8517; 8525 to 8536: 8538 to 8547.
33	Production, import and supply or trading of following medical devices, namely:- i. Cardiac stents; ii. Drug eluting stents; iii. Catheters; iv. Intra ocular lenses; v. Bone cements; vi. Heart valves; vii. Orthopaedic implants; viii. Internal prosthetic replacements; ix. Scalp vein set;	9018 to 9022

	x. Deep brain stimulator; xi. Ventricular peripheral shud; xii. Spinal implants; xiii. Automatic impalpable cardiac deflobillator; xiv. Pacemaker (temporary and permanent); xv. Patent ductus arteriosus, atrial septal defect and ventricular septal defect closure device; xvi. Cardiac re-synchronise therapy; xvii. Urethra spinicture devices; xviii. Sling male or female; xix. Prostate occlusion device; and xx. Urethral stents:	

Provided that nothing contained in serial number 33 shall apply to foreign companies having only liaison offices.

Provided further that nothing contained in this rule shall apply to a company which is classified as a micro enterprise or a small enterprise including as per the turnover criteria under sub-section (9) of section 7 of the Micro. Small and Medium Enterprises Development Act, 2006 (27 of 2006)].

* *Source: www.mca.gov.in; https://icmai.in/icmai/index.php*