COST AUDIT

1. Explain Cost Audit.

- ⇨ According to the Institute of Cost and Management Accountants of England, cost audit represents the verification of cost accounts and a check on the adherence to cost accounting plan.
- ⇨ Cost audit, therefore, comprises:
  a. Verification of the cost accounting records such as the accuracy of the cost accounts, cost reports, cost statements, cost data and costing techniques, and
  b. Examination of these records to ensure that they adhere to the cost accounting principles, plans, procedures and objectives.

2. Write short notes on Types of Cost Audit.

⇨ ***ON BEHALF OF THE MANAGEMENT:***

- ✳ Establishing accuracy of cost data
- ✳ Whether objectives of Cost Account being achieved.
- ✳ Abnormal losses and gains with causes.
- ✳ Determine unit cost of production
- ✳ Proper overhead rates.
- ✳ Fixation of contract price.
- ✳ Improving quality of Cost Accounting System

⇨ ***ON BEHALF OF A CUSTOMER:***

- ✳ In case of cost plus contracts, often the buyer or the contractee insists on a cost audit to satisfy himself about the correct ascertainment of cost.
- ✳ The cost of production arrived at for this purpose may differ from the cost of production ascertained for internal purposes.

⇨ ***ON BEHALF OF GOVERNMENT:***

- ✳ Sometimes, government is approached with requests for subsidies, protection, etc.
- ✳ The government, of its own also may initiate cost audit, in public interest to establish the fair price of any product.

⇨ ***BY TRADE ASSOCIATION:***

- ✳ Where activities of a trade association include maintenance of a price of the products manufactured by the member units or
- ✳ Where there is pooling or contribution arrangements, the trade association may require the accuracy of costing information submitted by the member-units checked.

⇨ ***STATUTORY COST AUDIT:*** This is covered by the provisions of Section 233B of the Companies Act.

3. *What are the advantages that accrue because of a Cost audit? Or Advantage of Cost audit to government (N' 04- 4 Marks)*

ADVANTAGES OF COST AUDIT

- **To Management**
  1. reliable data
  2. check on wastage
  3. inefficiency & corrective action
  4. MBE
  5. Budgetary control & Standard Costing
  6. Valuation of closing stock
  7. detection of error and fraud
- **To Society**
  1. Fixation of Price
  2. Justification of price increase by increase in cost of production
- **To Shareholder**
  - Proper records are kept for material, wages, etc.
- **To Government**
  1. Cost plus contract
  2. Ceiling price
  3. Inefficient unit.
  4. Protection to certain industries
  5. Settlement of Trade dispute.
  6. Healthy competition among units in industry.

4. *Write a short note on - True and Fair Cost of Production. (M'01,N'02- 4 , 6 Marks)*

- A cost auditor checks the cost accounting records to verify that the cost statements are properly drawn up as per the records and that they present a true and fair view of the cost of production and marketing of various products dealt with by the undertaking.
- The Cost Audit (Report) Rules, 1996 as amended in 2001, prescribe the rules regarding the cost audit report. The prescribed format of the report contains assertions regarding whether cost accounting records have been properly kept so as to give a true and fair view of the cost of production/ processing/ manufacturing/ mining activities and marketing of the product under reference.
- It may be noted that unlike in the case of audit of financial statements, the cost auditor does not have to state whether the cost statements reflect a true and fair view.
- following are the relevant considerations in determining whether the cost of production determined is true and fair:
  - Determination of cost following the generally accepted cost accounting principles.
  - Application of the costing system appropriate to the product.
  - Materiality.
  - Consistency in the application of costing system and cost accounting principles.
  - Maintenance of cost records and preparation of cost statements in the prescribed form and having the prescribed contents.
  - Elimination of material prior-period adjustments.
  - Abnormal wastes and losses and other unusual transactions being ignored in determination of cost.

5. For what purposes the Cost Auditor refers to financial records while conducting Cost Audit of an entity? (M' 02- 8 Marks) or Write a short note on - Reconciliation of cost and financial accounts. (M'03- 4 Marks)

- A cost auditor is ultimately required to **EXPRESS AN OPINION** as to whether the company has maintained proper cost accounting records so as to give a true and fair view of cost of production, etc.
- In arriving at this opinion, the cost auditor is required to **ASCERTAIN ABOUT MULTITUDE OF INFORMATION** such as cost of raw materials consumed, cost of power, cost of stock, employer costs, provision for depreciation, royalty and technical payment, abnormal cost, scrap, fuel etc.
- **ANNEXURE** to the cost audit reports require detailed information in respect of financial position including capital employed, net worth, profit, net rates, operating profit, unit cost of power and fuel, total wages and salaries, etc.
- It is obvious therefore that cost audit cannot be done without **REFERENCE TO FINANCIAL BOOKS**, more so in the context of the statutory requirement to have a statement of reconciliation with financial accounts as part of cost audit report.
- Further the cost statements also contain a **SUMMARY OF ALL EXPENDITURE** incurred by the company and the share in such expenditure attributable to the activities covered by Cost Accounting Records Rules; Overhead expenditure also needs allocation between activities covered by rules and activities not so covered. Naturally this can be done only with reference to financial ledger.
- Under **PART II OF SCHEDULE VI** to the Companies Act, 1956, quite a few matters which are to be mentioned in the Profit and Loss Account of the company are also to be covered in cost statements such as consumption of raw materials in quantity and value, sale of finished goods under classified headings in quantity and nature, actual production quantity of value, inventory in quantity of value for each class of goods, etc.
- A **CORRELATION BETWEEN CONSUMPTION OF RAW MATERIALS** as per cost records and financial records may throw up the need for inquiry into errors, mistakes and manipulation.
- **MATERIAL DISCREPANCY** between financial records and cost records will be highlighted in the reconciliation statement which would required that the cost auditor may examine deviation before reporting on the same.
- Thus it is imperative for the cost auditor to refer to financial records for conducting the cost audit.

6. "Like every other audit, a systematic planning for cost audit is also necessary". Indicate the matters to be included in a Cost Audit Programme. (N'05- 10 Marks)

- ***Matters to be included in Cost Audit Programme****: It is a true statement that like any other audit a systematic planning for cost audit is also necessary. Therefore, the cost audit programme should include all the usual broad steps that a financial auditor includes in his audit programme.*
- *This would require that the various aspects like what to be done, when to be done and by whom to be done are adequately takes care of.*
- *However, looking to the basic difference in cost audit and financial audit as allocation and apportionment of expenses, statutory requirement etc. should require special consideration.*
- *Cost audit, in order to be effective, should be completed at one time as far as practicable.*
- *Based on above factors a set of procedures and instructions are evolved which may be termed the cost audit programme.*
- *Matters to be included in the Cost Audit Programme may be divided into following two stages:*

a) Review of Cost accounting record: This will include:

i. Method of costing in use - batch, process or unit.
ii. Method of accounting for raw materials; stores and spares, wastages, spoilage defectives, etc.

iii. System of recording wages, salaries, overtime and spares, wastages, etc.
iv. Basis of allocation of overheads to cost centres and of absorption by products and apportionment of service department's expenses.
v. Treatment of interest, recording of royalties, research and development expenses, etc.
vi. Method of accounting of depreciation.
vii. Method of stock-taking and its valuation including inventory policies.
viii. System of budgetary control.
ix. System of internal auditing.

b) Verification of cost statement and other data: This will mainly cover:

i. Licensed, installed and utilized capacities.
ii. Financial ratios.
iii. Production data.
iv. Cost of raw material consumed, wages and salaries, stores, power and fuel, overheads provision for depreciation etc.
v. Sales realization.
vi. Abnormal non-recurring and special costs.
vii. Cost statements.
viii. Reconciliation with financial books.

⇨ Some other factors which need to be brought into cost audit programme includes system of cost accounting, range of products, areas to be covered etc. indicating allocation of manpower and the time to be taken for computing the audit.