

## 15. Audit under fiscal Laws

### Important Point of this chapter

1.

### Introduction

Cost Audit comprises

- a. Verification of the cost accounting records such as the accuracy of the cost accounts, cost concepts, 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.

### Types of Cost Audit

1. Cost audit on behalf of the management
2. Cost audit on behalf of a customer
3. Cost audit on behalf of government
4. Cost audit by trade association
5. Statutory cost audit

From above types there is also other type of cost audit also which is undernoted circumstances may warrant the introduction of cost audit. List of that are as follows:

- a. Price fixation
- b. Cost variation within the industry
- c. Inefficient management
- d. Tax-assessment
- e. Trade disputes

### Advantages of Cost Audit

#### 1. To Management

- Management will get reliable data for its day-to-day operations like price fixing, control, decision making etc.
- A close and continuous check on all wastages will be kept through a proper system of reporting to management
- Inefficiencies in the working of the company will be brought to light to facilitate corrective action.
- Management by exception becomes possible through allocation of responsibilities to individual managers.
- The system of budgetary control and standard costing will be greatly facilitated
- A reliable check on the valuation of closing stock and WIP can be established.
- It helps in the detection of errors and frauds

#### 2. To Society

- Cost audit often introduced for the purpose of fixation of prices. The prices so fixed are based on the correct costing and so the consumers are saved from exploitation.

- Since price increase by some industries is not allowed without proper justification as to increase in cost of production, inflation through price hikes can be controlled and consumers can maintain their standard of living.

### 3. To Shareholder

- Cost audit ensures that proper records are kept as to purchase and utilization to material and expenses incurred on wages etc. it also makes sure that the valuation of closing stock and WIP is on a fair basis.

### 4. To Government

- Where the government enters into a cost-plus contract, cost audit helps government to fix the price of the contract at reasonable level.
- Cost audit helps in the fixation of ceiling prices of essential commodities and thus undue profiteering is checked.
- Cost audit enables the government to focus its attention on inefficient units.
- Cost audit enables the government to decide in favour of giving protection to certain industries.
- Cost audit facilitates settlement of trades disputes brought to the government.
- Cost audit and consequent management action can create a healthy competition among the various units in an industry. This imposes an automatic check on inflation.

### **Programmed of cost audit**

The audit programmed should include all the usual broad steps that a financial auditor includes in his audit programmed. But the exact content of cost audit largely depends on the size of the organization, range of products, production process, the existence of a well organized costing department and of a well designed costing system, and the existence of a capable internal auditing system. Other relevant consideration is as follows:

- a. System of cost accounting in vogue and the organization of the cost department, forms, schedules etc.
- b. System of internal check used in the organisation.
- c. Frequency of audits, areas to be covered, volume of transaction, efficiency of the internal checks, needs of management, purpose of cost audit, its benefits etc.

Broadly speaking the programmed of cost audit divided into the following stages:

#### 1. Review of cost accounting records

- Method of costing in use – batch, process or unit.
- Method of accounting for raw materials; stores and spares; wastages, spoilage defectives etc.
- System of recording wages, salaries, overtime and spares wastages etc.
- Basis of allocation of overheads to cost centers and of absorption by products and apportionment of service department's expenses.
- Treatment of interest recording of royalties, research and development expenses etc.
- Method of accounting of depreciation.
- System of budgetary control.
- System of internal auditing.

2. Verification of cost statements and other data
  - Licensed, installed and utilized capacities
  - Financial ratios
  - Production data
  - Cost of raw material consumed, wages and salaries, power and fuel, overheads, provision for depreciation etc.
  - Sales realization
  - Abnormal non-recurring and special costs
  - Cost statements
  - Reconciliation with financial books.

### **General Features of cost records**

1. Materials
2. Manufactured components and intermediaries
3. Spares and spare parts
4. Wages and salaries
5. Overheads
6. Service department expenses including expenses on utilities
7. Depreciation
8. Packing
9. By-products
10. Production and sales
11. Inventories
12. Variances
13. Cost statements
14. Reconciliation of cost and financial accounts
15. Royalty
16. Statistical records
17. Incorporation of provision relating to inter-company transfer in the cost accounting record rules.

### **Cost audit under the companies act (revised)**

Ministry has reviewed the existing procedures followed by the companies for seeking prior approval of the CG for appointment of cost auditor under section 233B(2) of the companies act. In supersession of any earlier order issued in this regard, the revised procedure to be followed by the companies and cost auditor shall be as under:

- a. The company required to get its cost records audited by cost auditor.
- 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 disqualification as specified under the act.
- d. While a cost auditor shall have primary responsibility to ensure that he does not violate the limits specified limit for audit.
- 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 CG in prescribed form within 90 days from the commencement of F.Y. about appointment of cost auditor with relevant document.
- g. On filing the application, same shall be deemed to be approved by the CG, unless contrary is heard within 30 days from the date of filing such application.
- h. If within 30 days CG demand more documents than 30 days shall be count from the resubmission date of revised application.
- i. After expiry of 30 days company shall issue formal letter of appointment to the cost auditor.
- j. After receiving appointment letter cost auditor should inform to CG about its consent within 30 days.
- k. The company shall disclose full particulars of the cost auditor, along with the due date and actual date of filing the cost audit report by the cost auditor, in its annual report to each relevant financial year.
  - If company fails to apply above provision than it/he should be punishable under act.
  - If cost auditor fails to comply with provision regarding his duty than he shall be punishable with fine, which may extend to 5,000 rupees.
  - The modified procedure continued in this circular applies from the financial year commencing on or after the 1<sup>st</sup> day of April 2011.
  - Exemption from cost audit: the exemption from cost audit on year-to-year basis in the following situation:
    - a. Situation:
      - i. Temporary closure of the company/products
      - ii. Negligible production activity
    - b. Fees for application
      - i. Authorised Share capital less than Rs. 25 lakh – Rs. 500
      - ii. Authorised Share capital 25 lakh or less than Rs. 5 crore lakh – Rs. 1000
      - iii. Authorised Share capital 5 crore or more – Rs. 1000
    - c. Documents required
      - i. Printed or attested true copy of annual report containing balance sheet and profit and loss account for the year for which exemption is being sought along with copies of the same pertaining to preceding two years.
      - ii. An affidavit containing full facts of capacity utilization, turnover and financial status of the company such as sick or not, duly signed by two directors of the company and authenticated by a notary public.
      - iii. A brief note/report on steps taken by the management for revival of the said unit.

### **True and Fair Cost of production concept for cost auditor**

The true and fair concept is known to us in the context of financial accounts. Based on that knowledge, it may be assumed that the following are the relevant consideration in deterring whether the cost of production determined is true and fair:

1. Determination of cost following the generally accepted cost accounting principles
2. Application of the costing system appropriate to the product.
3. Materiality
4. Consistency in the application of costing system and cost accounting principles.
5. Maintenance of cost records and preparation of cost statements in the prescribed form and having the prescribed contents.

6. Elimination of material prior-period adjustments.
7. Abnormal wastes and losses and other unusual transactions being ignored in determination of cost.

#### **Annexure to cost audit report**

1. General
2. Cost accounting system
3. Process of manufacture
4. Quantitative details
5. Major Input Materials/ Component consumed
6. Break-up of cost of input material imported during the year.
7. Power, fuel and utilities.
8. Salaries and wages
9. Repairs and Maintenance
10. Fixed assets register and depreciation
11. Gross Block, Depreciation and lease rent
12. Overheads
13. Research and development expenses
14. Royalty and technical know how charges
15. Quality control process
16. Pollution control process
17. Abnormal Non recurring cost
18. Non-Moving Stock
19. Written off stock
20. Inventory valuation
21. Physical verification of inventory
22. Sales of the product under reference
23. Margin per unit of output
24. Competitive margin against imports
25. Value addition and distribution of earnings
26. Financial position and ratio analysis
27. Capitalization of revenue expenditure
28. Related party transactions
29. Central excise reconciliation for the product under reference
30. Profit reconciliation

#### **Central excise reconciliation for the product under reference**

- i. Qualitative detail: auditor is required to give details of opening stock, production, total sales and closing stock of finished goods.
- ii. Details of clearance: under this auditor is required to give details of assessable value, rate and amount of duty on total exercisable clearance and total duty payable.
- iii. Summary of Cenvat Credit:
- iv. Reconciliation of duty paid
- v. Reconciliation of duty paid and recovered
- vi. Reconciliation of turnover