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## Cost Audit

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### Question 1

*Write a short note on Cost Audit.*

*(4 Marks, November, 2014)*

### Answer

**Cost Audit:** It is covered by Section 148 of the Companies Act, 2013. As per section 148 the Central Government may by order specify audit of items of cost in respect of certain companies. Further, 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 utilisation 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.

It is 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.

The audit shall be conducted by a Cost Accountant in Practice who shall be appointed by the Board of such remuneration as may be determined by the members in such manner as may be prescribed.

No person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records and also that the auditor conducting the cost audit shall comply with the cost auditing standards.

The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter X of the Companies Act, 2013 shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

It is provided that the report on the audit of cost records shall be submitted by the cost accountant in practice to the Board of Directors of the company.

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 issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

Question 2

*Write a short note on Cost records in respect of by products. (4 Marks, November, 2013)*

Answer

Cost records in respect of By-products: Proper records should be maintained for each item of by-product, if any, showing the receipts, issues and balances both in quantity and value. The basis adopted for valuation of the by-products should be equitable and consistent. Records indicating the actual sales realisation of by-products should be maintained. If any expenses have been incurred in further process of by-products, such expenses should also be separately stated. The treatment of realization of By-products in the determination of cost of main product should also be mentioned.

Question 3

*Write a short note on Cost Statements. (4 Marks, May, 2012)*

Answer

Cost Statements: Cost Statements or cost sheets are required to be prepared as part of the cost records in respect of each product. The forms of cost sheets have been prescribed in the Annexure to the respective Rules. The forms have been so devised arranged that they progressively build up the cost of production of the concerned products. The nature, purpose and contents of the cost sheet depend upon the nature of the products, production method, process involved, cost centres and the elements that make up the cost.

Question 4

*Write a short note on Reconciliation of Cost and Financial Accounts. (5 Marks, November, 2010)*

Answer

Reconciliation of Cost and Financial Accounts: The cost records should be reconciled (preferably periodically) with the financial books of account so as to ensure accuracy. Variations, if any, should be clearly indicated and explained. The period for which such reconciliation be effected should not exceed the period of the financial year of the company. The reconciliation should be done in such a manner that profitability of the product under reference can be correctly adjudged and reconciled with the overall profits of the company. A statement showing the total expenses incurred by the company, including expenses excluded from the costing records and expenses on products not covered by the relevant Companies (Cost Records and Audit) Rules, should be prepared and the share of the product covered by the Rules in such expenses should be indicated. Also the sale realisation of the products should be shown separately for products covered by the Rules and products not so covered and the margin representing the difference between respective sales realisation and the corresponding total cost should be determined. This statement in turn should be reconciled with the financial statement of profit and loss for the period. It may be mentioned that where a system of integrated cost and financial accounting is in operation, this reconciliation will be facilitated to a large extent. It should be ensured that the specific information required to be contained in both the costing and financial statements is not different. If at all any difference arises, the same should be properly reconciled and kept on record for reference.

## Question 5

*What is the purpose served by Introduction of Cost audit?*

*(4 Marks, May, 2010)*

## Answer

**Introduction of 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-

- (i) verification of the cost accounting records such as the accuracy of the cost accounts, cost reports, cost statements, cost data and costing techniques, and
- (ii) examination of these records to ensure that they adhere to the cost accounting principles, plans, procedures and objectives.

The undernoted circumstances may warrant the introduction of cost audit:

- (i) **Price fixation** – The need for fixation of retention prices in the case of materials of national importance, like steel, cement etc., may be useful in knowing the true cost of production.
- (ii) **Cost variation within the industry** – where the cost of production varies significantly from unit to unit in the same industry, cost audit may be necessary to find the reasons for such differences.
- (iii) **Inefficient management** – Where a factory is run inefficiently and uneconomically, institution of cost audit may be necessary. It may be particularly useful for the Government before it takes over any unit.
- (iv) **Tax assessment** – Where a duty or tax is levied on products based on cost of production, the levying authorities may ask for cost audit to determine the correct cost of production.
- (v) **Trade disputes** – Cost audit may be useful in settling trade disputes about claim for higher wages, bonus, etc.

## Question 6

*What are the advantages that accrue to the stockholders of a company because of a Cost audit?*

*(8 Marks, May, 2007)*

## Answer

**Advantages of Cost Audit:** Cost Audit will be advantageous to the stockholders in the following manner-

**(A) To Management:**

- (i) Management will get reliable data for its day-to-day operations like price fixing, control, decision-making, etc.
- (ii) A close and continuous check on all wastages will be kept through a proper system of reporting to management.

- (iii) Inefficiencies in the working of the company will be brought to light to facilitate corrective action.
  - (iv) Management by exception becomes possible through allocation of responsibilities to individual managers.
  - (v) The system of budgetary control and standard costing will be greatly facilitated.
  - (vi) A reliable check on the valuation of closing stock and work-in-progress can be established.
  - (vii) It helps in the detection of errors and fraud.
- (B) To Society:
- (i) Cost Audit is often introduced for the purpose of price fixation. Customers are saved from exploitation through proper costing of products and services.
  - (ii) 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.
- (C) To Shareholders: Cost Audit ensures that proper records are kept as to purchases and utilization of materials and expenses incurred on wages etc. It also makes sure that the valuation of closing stock and work-in-progress is on a fair basis. The shareholders are assured about the calculation of the profitability and thus return on their investments.
- (D) To Government:
- (i) Where the Government enters into a cost-plus contract, cost audit helps government to fix the price of the contract at a reasonable level.
  - (ii) Cost audit helps in the fixation of selling prices of essential commodities and thus undue profiteering is checked.
  - (iii) Cost audit enables the government to focus its attention on inefficient units.
  - (iv) Cost audit enables the government to decide in favour of giving protection to certain industries.
  - (v) Cost audit facilitates settlement of trade disputes brought to the government.
  - (vi) 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.

**Question 7**

*"Like every other audit, a systematic planning for cost audit is also necessary". Indicate the matters to be included in a Cost Audit Programme. (10 Marks, November, 2005)*

**Answer**

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 taken 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 utilised 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 realisation.
  - (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.

Question 8

*Write a short note on Advantages of Cost Audit to Government. (4 Marks, November, 2004)*

Answer

**Advantages of Cost Audit to Government:** Cost auditor's approach is to ensure that the cost accounting plan is in consonance with the objectives set by the organisation and the system of accounting is geared towards the attainment of the objectives. A cost accounting system designed to exercise control over cost may be different from the one if the objective is to fix price. Accordingly, over a period of time particularly in view of administered pricing system the cost accounting becomes quite important. Some of the specific advantages which can be reaped by the Government are-

- (i) Where the Government enters into a cost-plus contract, cost audit helps government to fix the price of the contract at a reasonable level.
- (ii) Cost audit helps in the fixation of selling prices of essential commodities and thus undue profiteering is checked.
- (iii) Cost audit enables the government to focus its attention on inefficient units.
- (iv) Cost audit enables the government to decide in favour of giving protection to certain industries.
- (v) Cost audit facilitates settlement of trade disputes brought to the government.
- (vi) 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.