

SYLLABUS - 2016

COST AND MANAGEMENT AUDIT

FINAL

STUDY NOTES



The Institute of Cost Accountants of India

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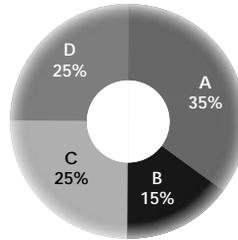
Syllabus- 2016

PAPER 19: COST AND MANAGEMENT AUDIT (CMAD)

Syllabus Structure

The syllabus comprises the following topics and study weightage:

A	Cost Audit	35%
B	Management Audit	15%
C	Internal Audit, Operational Audit and other related issues	25%
D	Case Study on Performance Analysis	25%



ASSESSMENT STRATEGY

There will be written examination (including case study / caselet analysis) paper of three hours

OBJECTIVE

To promote the knowledge of Cost and Management Accountancy to provide educational facilities for training of budding professionals for excelling in the field of management accounting. To promote the decision-making skills and administrative competence relevant to management accounting and corporate management in general.

Learning Aims

The syllabus aims to test the student's ability to:

- Focus on basic cost information, appropriately computed cost centre wise, system based cost data support for decision-making processes
- Ensure uniformity and maintain cost records as per Generally Accepted Cost Accounting Principles
- Tabulate the cost information and construct the system thus evolved for gainful operation and use in the strategy making for measuring productivity, profitability, etc.
- Prepare cost audit report in compliance with statutory obligations
- Understand the usefulness of cost audit and interpret for stakeholders view
- Discuss the concepts of management audit and demonstrate its usefulness
- Evaluate the performance of an organization through cost accounting records and cost audit reports
- Recommend desired course of action for optimal utilization of scarce resources which can lead to improve the productivity and profitability of an organization

Skill Set required

Level C: Requiring skill levels of knowledge, comprehension, application, analysis, synthesis and evaluation.

Section A : Cost Audit	35%
1. Nature, Scope, Utility and Advantages of Cost Audit	
2. Companies (Cost Records & Audit) Rules, 2014	
3. Professional Ethics, Misconduct, Offences and Penalties	
4. Cost Accounting Standards	
5. Cost Auditing and Assurance Standards	
6. Format of Cost Audit Report – XBRL – Salient Features	
Section B: Management Audit	15%
7. Management Reporting issues under Cost Audit	

8. Management Audit – Meaning, Nature, Scope etc.	
9. Energy Audit, Efficiency Audit, Propriety Audit and Systems Audit	
10. Evaluation of Corporate Image – Corporate Development Audit	
11. Impact of Environmental Pollution	
Section C: Case Study on Performance Analysis	25%
12. Concept of Internal Audit	
13. Provisions of Internal Audit under Companies Act, 2013	
14. Audit Planning, Audit Programme, Audit working papers	
15. Receivables Audit, Audit of Services and Local Bodies	
Section D: Case Study on Performance Analysis	25%

SECTION A: COST AUDIT [35 MARKS]

1. Nature, Scope, utility and Advantages of Cost Audit
2. Companies (Cost Records and Audit) Rules, 2014
3. Professional Ethics, Misconduct, Offences and Penalties
4. Cost Accounting Standards
5. Cost Auditing Assurance Standards
6. Format of Cost Audit Report – XBRL – Salient features

Section B: Management Audit [15 marks]

7. Management Reporting issues under Cost Audit – Performance Appraisal Report
8. Management Audit – Meaning, Nature, Scope, Need for Management Audit and Reporting under Management Audit
3. Energy Audit, Efficiency Audit, Propriety Audit and Systems Audit
4. Evaluation of Corporate Image - Corporate Development Audit –Corporate Strategy Audit
5. Impact of environmental pollution: Social Cost Benefit Analysis, Corporate Social Audit and Safety audit.

Section C: Internal Audit, Operational Audit and other related issues [25 marks]

7. **Internal audit and operational audit**
 - (a) Concept of Internal Audit
 - (b) Provisions of Internal Audit under Companies Act, 2013
 - (c) Audit Planning, Audit Programme, Audit working papers, Reporting to Management
 - (d) Receivables Audit, Audit of Hospitals, Hotels, educational Institutions, Co-operative Societies, Self Help Groups, Non-Governmental Organizations (NGOs), corporations, Municipalities, Panchayats.

Section D: Case Study on Performance Analysis [25 marks]

Case Study on the basis of the Companies Performance for managerial decision-making with reference to:

- (a) Application of Ratios for assessment of performance
- (b) Waste Multiplier
- (c) Utilities Consumption i.e., Power, Fuel etc
- (d) Capacity determination and Utilization
- (e) Value Addition
- (f) Inventory valuation
- (g) Abnormal Events such as Strike, Lock-out and other factors
- (g) Profitability analysis
- (h) Reconciliations of Financial and Cost Records i.e., Profit, Taxation

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Study Note - 1

BASICS OF COST AUDIT



This Study Note includes

- 1.1 Nature of Cost Audit
- 1.2 Origin of Cost Audit
- 1.3 Genesis of Cost Audit
- 1.4 Relevance of Cost Audit
- 1.5 Objectives of Cost Audit
- 1.6 Legal Framework of Maintenance of Cost Records and Cost Audit
- 1.7 Companies (Cost Records and Audit) Rules, 2014

1.1 NATURE OF COST AUDIT

Cost Audit involves an examination of cost books, cost accounts, cost statements and subsidiary and prime documents with a view to satisfying the auditor that these represent true and fair view of the cost of production. This includes the examination of the appropriateness of Cost Accounting system.

According to Chartered Institute of Management Accountants, London (CIMA), cost audit is "the verification of the correctness of cost accounts and of the adherence to the cost accounting plan". In other words, cost audit is the verification of the cost of production of any product, service or activity on the basis of accounts maintained by an enterprise in accordance with the accepted principles of cost accounting. This definition of Cost Audit is relevant to the voluntary Cost Audit without any statutory backing.

The Institute of Cost Accountants of India on the other hand, defines cost audit as "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." Thus the concept and scope of cost audit as defined in India is more specific and lays emphasis on the evaluation of the efficiency of operations and the propriety of management actions as introduced by the Government of India for specified industries. In this sense, cost audit in India appears to be synonymous with efficiency audit mainly as a guide for management policy and decision making besides being a barometer of actual performance.

1.2 ORIGIN OF COST AUDIT

In India, methods and techniques of cost accounting and audit of cost accounts can be traced back to pre-independence era when a large number of firms were given contracts by the Government of India on cost plus basis. The Government then started verifying and investigating into the cost structure of such firms. This trend continued on a large scale during World War II that led to the recognition of cost as a distinct concept not only in India but also in the industrial economies of the world. A phenomenon of cost consciousness started taking shape in the country and the Institute of Cost and Works Accountants of India was set up in 1944 with the objectives of promoting, regulating, and developing the profession of cost accountancy in the country. The Institute of Cost and Works Accountants of India (now The Institute of Cost Accountants of India) was later incorporated as a statutory body by an Act of Parliament in 1959. In moving the Cost and Works Accountants Bill for reference to the Joint Committee, the Deputy Minister of Commerce and Industry explained the nature and purpose of cost accounting as follows (Lok Sabha Debates, Vol. XXIV, dated 20th December, 1958, pp. 6608-09):

"Cost accounting is a function entirely different from general or financial accounting. Cost accountancy covers a wide range of subjects, with special emphasis on cost accounting, factory organization and management,

engineering techniques, and knowledge of the working of the factories. The cost accountant performs services involving pricing of goods, preparation, verification, certification of cost accounts and related statements, or recording presentation or certification of cost facts or data. In a manufacturing concern, he works out the economical cost of production and evaluates its progress at each stage of production. In mass production enterprises, he points out wastage of manpower due to overstaffing or inefficient organization and indicates the output, the capacity of the machines and labour, the stock position, the movement of stores and weakness in the production process. The systematic determination of cost in every single and distinct process of manufacturing provides a continuous check on the margin of waste in the processing of raw and semi-finished materials, on the utilisation of machinery installed, on manpower expended and the percentage of rejection of finished products. This pinpoints also the particular process in which defects and deficiencies exist, thereby enabling immediate remedial measure being taken. Costing, in short, aims at making the organization efficient and economical, by providing the minimum of labour and material and getting the full capacity of the machine output. The cost accountant, therefore, is concerned solely and mainly with the internal economy of the industry, and renders services essential to the day-to-day management of the undertaking."

1.3 GENESIS OF COST AUDIT

In the mid-fifties, famous case of corporate frauds in Dalmia-Jain companies virtually jolted the then Government. It resulted in the Government appointing Vivian Bose Commission and later the Dutta Commission and Daphtary-Sastri Committee. These Commissions/ Committees observed inadequacies in the then existing system of financial accounting and audit and also in the then existing system of corporate disclosures. They recommended a more effective system of cost accounting and cost audit, to supplement the financial accounting and auditing practices. Further, in the initial phase of industrial development of the country, there was an acute shortage of goods & materials, as well as, majority of inputs and resources for the production/manufacture of various capital & consumer goods. In the face of scarcity and shortage of almost all the inputs, products and services, Government had to resort to a policy of permits and licensing. A mechanism of Cost audit and maintenance of structured cost data were considered as important instruments in the hands of the regulatory authorities to monitor, control and regulate the efficient use of scarce resources and inputs so made available and monitor cost of production and administer prices. Thus, Cost Audit as a unique feature of corporate management in India, emerged.

1.4 RELEVANCE OF COST AUDIT

In the initial years, Cost Audit was taken merely as a tool for 'price control mechanism' for consumer and infrastructure industries in India. The main objective of Cost Audit when statutorily introduced under the provisions of the Companies Act, 1956 was to meet the Government requirements for regulating the price mechanism in some core industries. The objective was to provide an authentic data to the Government to regulate the demand and supply in the country through a price control mechanism.

The liberalization of the economy and consequential globalization has further enhanced the need for authentic data.

The Expert committee formed by the Government of India to study the Cost Audit scenario in the country, highlighted the following benefits of cost information:

- ❖ Cost Information enables the organization to structure the cost, understand it and use it for communicating with the stakeholders
- ❖ Costing is an important tool in assessing organizational performance in terms of shareholder and stakeholder value. It informs how profits and value are created, and how efficiently and effectively operational processes transform input into output. It contributes to the data input on economy level parameters like resources efficiency, waste management, resources allocation policies etc.
- ❖ Costing includes product, process, and resource-related information covering the functions of the organization and its value chain. Costing information can be used to appraise actual performance in the context of implemented strategies.



- ❖ Good practice in costing should support a range of both regular and non-routine decisions when designing products and services to :
 - meet customer expectations and profitability targets;
 - assist in continuous improvements in resources utilisation; and
 - guide product mix and investment decisions.
- ❖ Working from a common data source (or a single set of sources) also helps to ensure that output reports for different audiences are reconcilable with each other.
- ❖ Integrating databases and information systems can help to provide useful costing information more efficiently as well as reducing source data manipulation.

As per International Federation of Accountants (IFAC), the general principles of costing and the design of costing systems in this Guidance are generally applicable to all types of organization. For example, cost information is an equally important driver of performance information and reporting in public and not-for-profit organizations. However, some jurisdictions apply legislative expectations on performance. These legislative mandates require reporting entities to develop and report cost information on a consistent and regular basis. Rules in some jurisdictions prescribe the calculation of unit costs to (a) allow comparisons between public authorities, and (b) establish the performance of specific activities. Cost audits help to ascertain whether an organization's cost accounting records are so maintained as to give a true and fair view of the cost of production, processing, manufacturing, and mining of a product. Therefore, cost audits can be used to the benefit of management, consumers and shareholders by (a) helping to identify weaknesses in cost accounting systems, and (b) to help drive down costs by detecting wastage and inefficiencies. Cost audits are also of assistance to governments in helping to formulate tariff and taxation policies.

The Expert Group noted that the Indian economy has to migrate from the current status to the top end position of the global competitiveness index in a short/medium time span. In a paper published by Mr. P.L. Joshi (University of Bahrain in 2001) based on a survey of firms in India on adoption of management accounting techniques it has been stated that, "Indian managements are generally conservative in adopting to new techniques of management accounting." Considering the maturity levels of cost and management accounting in Indian economy caused by the legacy of protected environment, we have a long way to traverse without the luxury of time. We do not have the luxury of a long experience curve for this to happen and need to work out the strategies including policy intervention which will position cost and management accounting as a soft infrastructure towards building national competitiveness. We can look at the following maturity levels for devising a strategy:

- Base Level : Plethora of legacy practices of cost accounting/ management
- Level II : A National standard level of cost accounting discipline
- Level III : A self driven level of world class cost/management accounting

The Expert Group was of the view that migrating through above levels should be at great speed and especially Level II will require statutory drive through standard cost accounting practices for the entire corporate sector. Once an enterprise crosses Level II into Level III it will be in a mode of voluntary adoption of all cost and management accounting guidelines to be issued by professional bodies either for internal financial management or for external reporting.

Hence, the Expert Group recommended phased introduction of cost accounting and cost audit framework in all companies to achieve the highest levels of competitiveness

The Group strongly believed that the Indian economy is at a maturity level of II. Therefore, instead of strict rules and laws, Indian industry needs directions, principles and guidance from the Government. At this maturity level, the Group felt that the industry should be given more freedom and flexibility and ultimately, over a period of time, the industry will achieve sufficient maturity level where driving force will be self discipline rather than any law of the Government. Till Indian industry reaches at the highest level of maturity, there is a need for compliance & monitoring mechanism in all fundamental parameters of economic activities.

The group also recognized that there is a major focus shift from the corporate governance to the enterprise governance. IFAC too, has started recognizing the need for adequate cost information and reporting framework to the governing body of enterprises for risk-management and decision making needed to enhance the stakeholders' value. IFAC has also very clearly highlighted the usage of such framework in the functioning of government and other public agencies. It is significantly clear that government regulation has to come to stay in the global economy. The international bodies, concerned with economic activities, like WTO, European Union etc. have emphasized the need for regulation in one form or other. At present, the regulatory bodies have prescribed their own formats in which the companies are required to submit the necessary cost information. In the absence of accurate and reliable cost data at the end of the companies/utilities, the regulatory bodies cannot discharge their statutory responsibilities in, say, fixing the correct tariff and other charges. They take the certified cost data in the prescribed formats from the companies/service providers. Such data is generated from the companies costing systems and if they are not well designed and implemented, even the certified copies may not provide relevant and reliable data to the regulatory bodies on which they base their decisions. Hence, it is highly mandated and imperative to ensure that the companies are maintaining proper records of costing through well designed costing accounting system and get these records duly audited/certified from an independent cost expert.

1.5 OBJECTIVES OF COST AUDIT

Cost Audit has both general and social objectives. The *general objectives* can be described to include the following :

- ❖ Verification of cost accounts with a view to ascertaining that these have been properly maintained and compiled according to the cost accounting system followed by the enterprise.
- ❖ Ensuring that the prescribed procedures of cost accounting records rules are duly adhered to.
- ❖ Detection of errors and fraud.
- ❖ Verification of the cost of each "cost unit" and "cost center" to ensure that these have been properly ascertained.
- ❖ Determination of inventory valuation.
- ❖ Facilitating the fixation of prices of goods and services.
- ❖ Periodical reconciliation between cost accounts and financial accounts.
- ❖ Ensuring optimum utilization of human, physical and financial resources of the enterprise.
- ❖ Detection and correction of abnormal loss of material and time.
- ❖ Inculcation of cost consciousness.
- ❖ Advising management, on the basis of inter-firm comparison of cost records, as regards the areas where performance calls for improvement.
- ❖ Promoting corporate governance through various operational disclosures to the directors.

Among the social objectives of cost audit, the following deserve special mention :

- ❖ Facilitation in fixation of reasonable prices of goods and services produced by the enterprise.
- ❖ Improvement in productivity of human, physical and financial resources of the enterprise.
- ❖ Channelising of the enterprise resources to most optimum, productive and profitable areas.
- ❖ Availability of audited cost data as regards contracts containing escalation clauses.
- ❖ Facilitation in settlement of bills in the case of cost-plus contracts entered into by the Government.
- ❖ Pinpointing areas of inefficiency and mismanagement, if any for the benefit of shareholders, consumers, etc., such that necessary corrective action could be taken in time.



1.6 LEGAL FRAMEWORK OF MAINTENANCE OF COST RECORDS AND COST AUDIT

Maintenance of Cost Records and Cost Audit are governed by the provisions of Companies Act, 2013.

- ❖ Section 2(13) of Companies Act, 2013, defines the 'books of accounts' to be maintained by the Companies. It includes "the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;"
- ❖ Section 128 of Companies Act, 2013, talks about the "Books of account, etc., to be kept by company",
- ❖ Section 148 of Companies Act, 2013, empowers the "Central Government to specify audit of items of cost in respect of certain companies" and
- ❖ Sub-Sections (2) to (5) of section 147 of Companies Act, 2013 contain the provision of "Punishment for contravention"
- ❖ Section 469 which empowers Central Government to make Rules.

The provisions of these Sections are reproduced below:

Section 2(13) of Companies Act, 2013, defines that:

"Books of account" includes records maintained in respect of—

- i. all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
- ii. all sales and purchases of goods and services by the company;
- iii. the assets and liabilities of the company; and
- iv. the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;

Section 128 of Companies Act, 2013, talks about the "Books of account, etc., to be kept by company", as follows:

- (1) Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting:

Provided that all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within seven days thereof, file with the Registrar a notice in writing giving the full address of that other place:

Provided further that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

- (2) Where a company has a branch office in India or outside India, it shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarized returns periodically are sent by the branch office to the company at its registered office or the other place referred to in sub-section (1).
- (3) The books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours, and in the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as may be prescribed:

Provided that the inspection in respect of any subsidiary of the company shall be done only by the person authorized in this behalf by a resolution of the Board of Directors.

- (4) Where an inspection is made under sub-section (3), the officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.
- (5) The books of account of every company 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 together with the vouchers relevant to any entry in such books of account shall be kept in good order:

Provided that where an investigation has been ordered in respect of the company under Chapter XIV, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.

- (6) If the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person of a company charged by the Board with the duty of complying with the provisions of this section, contravenes such provisions, such managing director, whole-time director in charge of finance, Chief Financial officer or such other person of the company shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.

Section 148 of Companies Act, 2013, empowers the “Central Government to specify audit of items of cost in respect of certain companies”, as under:

- (1) Notwithstanding anything contained in this Chapter, 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:

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

Explanation— for the purposes of this sub-section, the expression “cost auditing standards” mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.

- (4) An audit conducted under this section shall be in addition to the audit conducted under section 143.
- (5) The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter 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:

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

- (6) 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.



- (7) 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.
- (8) If any default is made in complying with the provisions of this section,—
 - (a) The company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;
 - (b) The cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (5) of section 147.

Sub-Sections (2) to (5) of section 147 of Companies Act, 2013 contain the provision of “Punishment for contravention” of his duties by a Cost auditor. These sub-sections read as:

- (2) If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees:

Provided that if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

- (3) Where an auditor has been convicted under sub-section (2), he shall be liable to—
 - (i) Refund the remuneration received by him to the company; and
 - (ii) Pay for damages to the company, statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.
- (4) The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.
- (5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of firm jointly and severally

469. Power of Central Government to make rules

- (1) The Central Government may, by notification, make rules for carrying out the provisions of this Act.
- (2) Without prejudice to the generality of the provisions of sub-section (1), the Central Government may make rules for all or any of the matters which by this Act are required to be, or may be, prescribed or in respect of which provision is to be or may be made by rules.
- (3) Any rule made under sub-section (1) may provide that a contravention there of 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.
- (4) Every rule made under this section and every regulation made by Securities and Exchange Board under this Act, shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or

regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

To sum up:

- ❖ Cost Records means the records maintained in respect of the items of cost as prescribed under section 148 of the Act [Section 2(13)(iv)]
- ❖ Cost records have to be maintained by the class of Companies for which, the Central Government prescribes the maintenance of such cost records, under Section 148 of the Act
- ❖ Cost audit has to be conducted by a Cost Accountant, for the class of Companies for which the maintenance of cost records is mandated under Section 148, subject to certain threshold limits of turnover.
- ❖ The procedure of appointment of the Cost auditor, conduct of cost audit and the rendition of the cost audit report to the Company, and subsequent uploading of the same to the Central government, etc are also contained in Section 148.
- ❖ Section 147(2) to 147(5) contains the penal provisions for contravention of the above provisions of audit by the cost auditor.

1.7 COMPANIES (COST RECORDS AND AUDIT) RULES, 2014

The salient features of these provisions, as they were amended from time to time and stand at this point of time (**As amended upto 15th July 2016**), are as follows:

- ❖ The Companies (Cost Records and Audit) Rules, 2014 has categorized the Companies into Regulated and Non-regulated Sectors, based on the product(s) / service(s) manufactured / provided by them;
- ❖ A Company engaged in manufacture / provision of any specified product(s)/service(s) is required to maintain Cost Records if its overall turnover exceeds ₹35 crores during immediately preceding Financial Year from all its the products and services;
- ❖ The cost records have to be maintained as specified in CRA-1
- ❖ The companies, falling under the Regulated sectors having overall annual turnover of ₹ 50 crores or more and the aggregate turnover of the individual product(s) or service(s) specified of ₹ 25 crores or more, have to get their Cost Records Audited;
- ❖ Six sectors are brought under the Regulated category, namely, Telecommunication services, Power generation, Transmission, Distribution and Supply; Petroleum products; Drugs and Pharmaceuticals; Fertilizers; Sugar and Industrial alcohol;
- ❖ The companies, falling under the Unregulated category viz. Business of plastics and polymers, glass, electrical, textiles, milk powder businesses, etc., having overall annual turnover of ₹ 100 crores or more and the aggregate turnover of the individual products or services specified of ₹ 35 crores or more, have to get their Cost Records Audited;
- ❖ Exemptions are provided to Companies whose revenue from exports, in foreign exchange, exceeds 75% of total revenue and Companies operating from Special Economic Zones.
- ❖ Provisions not applicable to companies classified as Micro enterprise and small enterprise as per MSME Development Act, 2006.
- ❖ Appointment of the Cost auditors has to be made as per the procedure laid down in the rules and Form-CRA-2 has to be electronically filed with MCA, intimating the appointment to the Central Government
- ❖ The Cost Auditor appointed has to render the cost audit report to the board of directors of the Company, as per the specified time limit, in Form-CRA-3
- ❖ The Company has to upload the report electronically to the MCA, along with explanations to the qualifications, if any, made by the Cost Auditor, in his report, through Form-CRA-4, within one month of its receipt by the Company.

Study Note - 2

COMPANIES (COST RECORDS AND AUDIT) RULES, 2014 (as amended upto 15th July 2016)



This Study Note includes

2.1 Companies (Cost Records and Audit) Rules, 2014 [as amended upto 15th July 2016]

2.1 COMPANIES (COST RECORDS AND AUDIT) RULES, 2014 [as amended upto 15th July 2016]

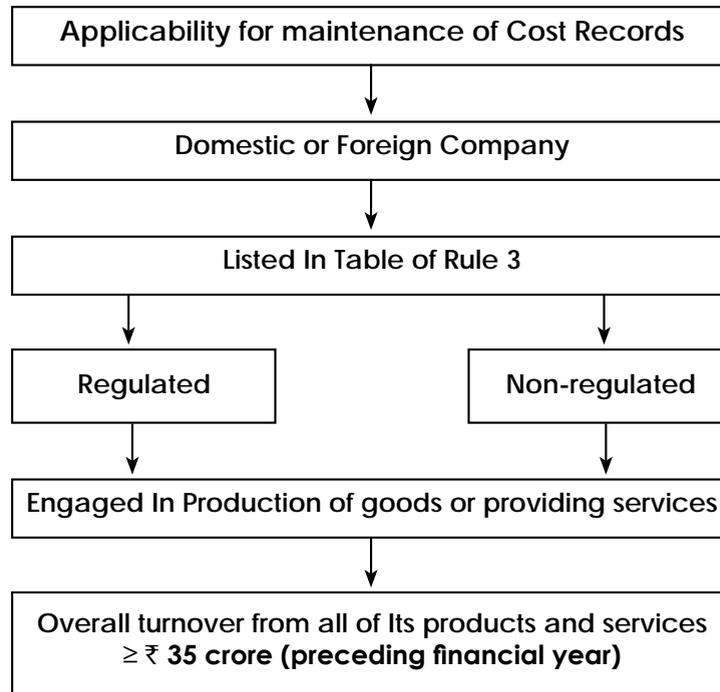
The Companies Act, 2013 empowers the Central Government to make the rules in the area of maintenance of cost records by the companies engaged in the specified industries, manufacturing / providing such goods / services; and for getting such cost records audited, vide Section 148.

Thus, it is the “subordinate legislative power” of the Central Government, to make rules for maintenance of cost records and audit thereof in respect of specific industries. Accordingly, the Central Government made, from time to time, several notifications / orders, ever since the provisions were made in the erstwhile Companies Act, 1956, as well as under the current Act of 2013.

An Analysis through diagrammatic representation.

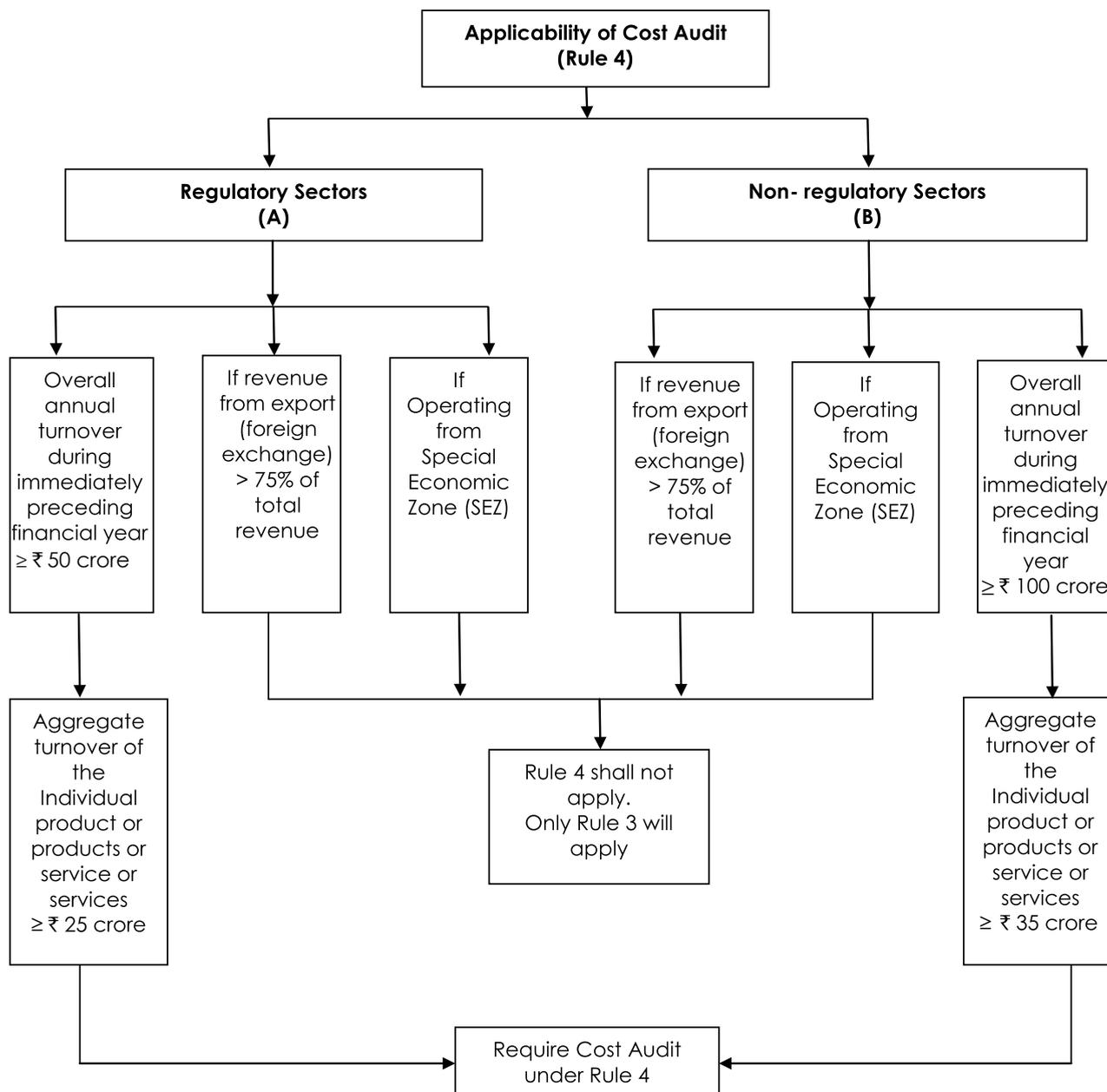
Rules/Forms	Summary
Rule 1: Short title and commencement	(1) These rules may be called the Companies (Cost Records and Audit) Rules, 2014. (2) They shall come into force on the date of publication in the Official Gazette i.e. 30.06.2014.
Rule 2: Definitions	In these rules, defined various points - (a) Act; (aa) Central Excise Tariff Act Heading; (b) Cost Accountant in practice; (c) cost auditor (d) cost audit report; (e) cost records; (f) form; (g) institute; (h) all other words and expressions used in these rules but not defined, and defined in the Act or in the Companies (Specification of Definition Details) Rules, 2014 shall have the same meanings as assigned to them in the Act or in the said rules.
Rule-3: Application of Cost Records	Two categories (regulated sectors and non-regulated sectors) have been retained and a general threshold of turnover of ₹ 35 crores or more has been prescribed for companies covered. Micro enterprise or a small enterprise as per MSMED Act, 2006 have been taken out of the purview.

Rule 3: Diagrammatic Representation

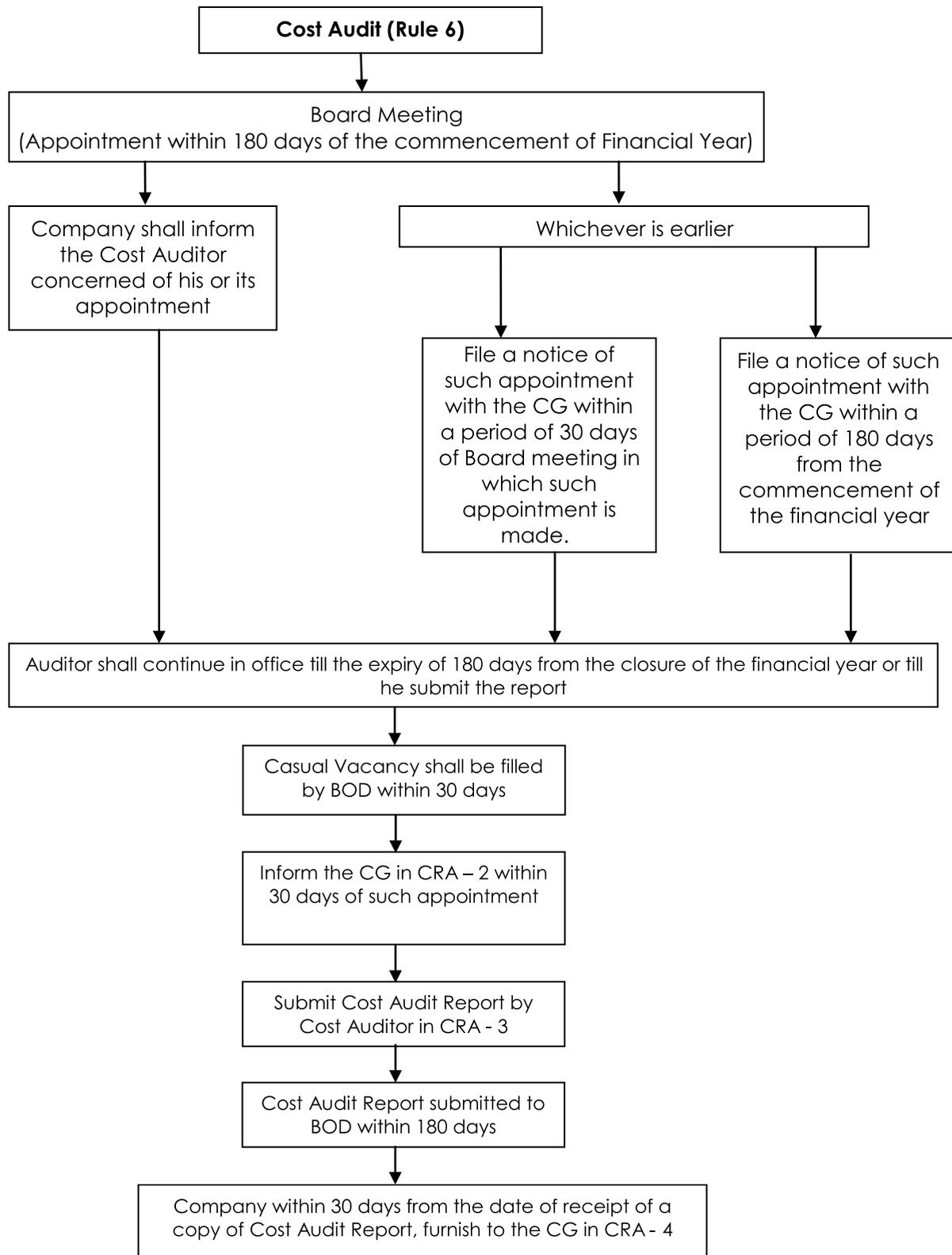


Rule-4: Applicability for Cost Audit	Even for regulated sectors like Telecommunication, Electricity, Petroleum and Gas, Drugs and Pharma, Fertilizers and Sugar, Cost audit requirement has been made subject to a turnover based threshold of ₹ 50 crores for all product and services and ₹ 25 crores for individual product or services. For Non-regulated sector the threshold is ₹ 100 crores and ₹ 35 crores respectively.
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Rule 4: Diagrammatic Representation



Rule-5: Maintenance of Cost Records	The requirement to maintain cost records in Form CRA-1 have been postponed to Financial Year 2015-16 for the following companies in some non-regulated sectors, namely; Coffee and Tea, Milk Powder and Electricals and electronic machinery.
Rule-6: Cost Audit	Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal to be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.





<p>CRA-1: Forms in which cost records shall be maintained</p> <p>[Pursuant to rule 5(1)]</p>	<p>The form CRA-1 prescribes the form in which cost records shall be maintained. The form categorises the requirement of maintaining proper details as per 30 headings. The headings are as follows: (1) Material Cost, (2) Employee Cost, (3) Utilities, (4) Direct Expenses, (5) Repair and Maintenance, (6) Fixed Assets and Depreciation, (7) Overheads, (8) Administrative Overheads, (9) Transportation Cost, (10) Royalty and Technical Know-how, (11) Research and Development expenses, (12) Quality Control Expenses, (13) Pollution Control Expenses, (14) Service Department Expenses, (15) Packing Expenses, (16) Interest and Financing Charges, (17) Any other item of Cost, (18) Capacity Determination, (19) Work-in-progress and finished stock, (20) Captive Consumption, (21) By-Products and Joint Products, (22) Adjustment of Cost Variances, (23) Reconciliation of Cost and Financial Accounts, (24) Related Party Transactions, (25) Expenses or Incentives on Exports, (26) Production records, (27) Sales records, (28) Cost Statements, (29) Statistical Records, (30) Records of Physical Verification.</p>
<p>CRA-2: Form of intimation of appointment of cost auditor by the company to Central Government</p> <p>[Pursuant to rule 6(2) & (3A)]</p>	<p>(1) Corporate Identity number (CIN) or foreign company registration number (FCRN) of the company</p> <p>(2) General Information</p> <p>(3) Product(s)/Service(s) to which Cost Audit relates</p> <p>(4) Details of all the Cost Auditor(s) appointed</p> <p>(5) Financial year to be covered under the Cost Audit</p> <p>(6) Details of previous Cost Auditor which has not been reappointed</p> <p>(7) Attachments</p> <ul style="list-style-type: none"> - Copy of the Board resolution of the company - Optional attachment - if any
<p>CRA-3: Form of Cost Audit Report</p> <p>[Pursuant to rule 6(4)]</p>	<p>Clause (vii) have been added to auditor's report as under:</p> <p>Detailed unit-wise and product/service-wise cost statements and schedules thereto In respect of the product/services under reference of the company duly audited and certified by me/us are/are not kept in the company.</p>

<p>Annexure to Cost Audit Report</p>	<p>Annexure has been reclassified into four parts as under:</p> <p>Part-A General Information, General Details of Cost Auditors, Cost Accounting Policy, Product/Service Details –for the company as a whole.</p> <p>Part-B For Manufacturing Sector Quantitative Information, Abridged Cost Statement, Details of Materials Consumed, Details of Utilities Consumed, Details of Industry Specific Operating Expenses.</p> <p>Part-C For Service Sector Quantitative Information, Abridged Cost Statement, Details of Materials Consumed, Details of Utilities Consumed, Details of Industry Specific Operating Expenses.</p> <p>Part-D Product and Service Profitability Statement, Profit Reconciliation, Value Addition and Distribution of Earnings, Financial Position and Ratio Analysis, Related Party Transactions, Reconciliation of Indirect taxes.</p>
<p>CRA – 4: Form for filing Cost Audit Report with the Central Government [Pursuant to rule 6(6)]</p>	<ol style="list-style-type: none"> (1) Corporate identity number (CIN) or foreign company Registration number (FCRN) of the company (2) General Information (3) Corporate identity number (CIN) or foreign company Registration number (FCRN) of the company (4) Details of Industries/Sectors/Product(s)/Service(s) (CETA heading level, wherever applicable as per Rules for Regulated and Non-regulated sector) for which the Cost Audit Report is being submitted (5) Details of Industries/Sectors/Product(s)/Service(s) (CETA heading level, wherever applicable as per Rules for Regulated and Non-regulated sector) not covered in the Cost Audit Report (6) Details of the cost auditor(s) appointed (7) Details of observation of the Cost Audit report (8) Attachment <ul style="list-style-type: none"> - XBRL document in respect of the cost audit report and Company's information and explanation on every Qualification and reservation contained therein - Optional attachment, if any.

Detailed Rule as per pronouncement by the MCA, GOI is reproduce for reference:-



The Companies (Cost Records and Audit) Rules, 2014 came into force on 30th June, 2014. These rules were amended on 31st December' 2014 giving effect to Rule 2, 3, 4, 5, 6, 7 and Form CRA 1 & CRA 3. It was further amended on 12th June'2015 to giving effect on Form CRA 2 & CRA 4. Further amendment was made on 14th July 2016.

Represented here under the existing provisions as applicable, after considering amendments till date, as mentioned above:

1. Short title and commencement

- (1) These rules may be called the Companies (cost records and audit) Rules, 2014.
- (2) They shall come into force from the date of their publication in the Official Gazette.

2. Definitions: In these rules, unless the context otherwise requires -

- (a) "Act" means the Companies Act, 2013 (18 of 2013);
- (aa) "Central Excise Tariff Act Heading" means the heading as referred to in the Additional Notes in the First Schedule to the Central Excise Tariff Act, 1985 [5 of 1986];
- (b) "Cost Accountant in practice" means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959), who holds a valid certificate of practice under sub-section (1) of section 6 of that Act and who is deemed to be in practice under sub-section (2) of section 2 thereof, and includes a firm or limited liability partnership of cost accountants;
- (c) "cost auditor" means a Cost Accountant in practice, as defined in clause (b), who is appointed by the Board;
- (d) "cost audit report" means the duly signed cost auditor's report on the cost records examined and cost statements which are prepared as per these rules, including attachment, annexure, qualifications or observations attached with or included in such report
- (e) "cost records" 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;
- (f) "form" means a form annexed to these rules;
- (g) "institute" means the Institute of Cost Accountants of India constituted under the Cost and Works Accountants Act, 1959 (23 of 1959);
- (h) all other words and expressions used in these rules but not defined, and defined in the Act or in the Companies (Specification of Definition Details) Rules, 2014 shall have the same meanings as assigned to them in the Act or in the said rules.

3. Application of Cost Records

For the purposes of sub-section (1) of Section 148 of the Act, the class of companies, including foreign companies defined in clause (42) of Section 2 of the Act, engaged in the production of the goods or providing services, specified in the Table below, 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 account, namely:-

TABLE

(A) Regulated Sectors

Sl. No	Industry/ Sector/ Product/ Service	Central Excise Tariff Act Heading (wherever applicable)
1	Telecommunication services made available to 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 under the Telecom Regulatory Authority of India Act, 1997 (24 of 1997); including activities that requires 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 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 3006.
5	Fertilizers;	3102 to 3105
6	Sugar and industrial alcohol	1701; 1703; 2207.

(B) Non-regulated Sectors

Sl No	Industry/ Sector/ Product/ Service	CETA Heading (wherever applicable)
1	Machinery and mechanical appliances used in defense,space and atomic energy sectors excluding any ancillary item or items; Explanation. - For the purposes 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 and ammunitions and Explosives	3601 to 3603; 9301 to 9306
4	Propellant powders; 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 per cent 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 by a Port in relation to a vessel or goods regulated by the Tariff Authority for Major Ports;	Not applicable.
8	Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008);	Not applicable.
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 being 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 signalling equipment's of all kind;	8601 to 8608.
14	Cement;	2523; 6811 to 6812
15	Ores and Mineral products;	2502 to 2522; 2524 to 2526; 2528 to 2530; 2601 to 2617
16	Mineral fuels (other than Petroleum), mineral oils etc.;	2701 to 2708
17	Base metals;	7401 to 7403; 7405 to 7413; 7419; 7501 to 7508; 7601 to 7614; 7801 to 7802; 7804; 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, 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 centres, clinical centres 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	Paper;	4801 to 4802
29	Textiles;	5004 to 5007; 5106 to 5113; 5205 to 5212; 5303; 5310; 5401 to 5408; 5501 to 5516
30	Glass;	7003 to 7008; 7011; 7016
31	Other machinery;	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; (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-synchronize therapy ; (xvii) Urethra spinicture devices; (xviii) Sling male or female; (xix) Prostate occlusion device; and (xx) Urethral stents:	9018 to 9022



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).

4. Applicability for Cost Audit

- (1) Every company specified in item (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 twenty five crore or more.
- (2) Every company specified in 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.
- (3) 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 per cent 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 Plant. For this purpose, the term "Captive Generating Plant" shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005"

5. Maintenance of records

- (1) 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 numbers 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.
- (2) 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.
- (3) 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.

6. Cost Audit

- (1) The 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 (1A), shall be obtained

- (1A) The cost auditor appointed under sub-rule (1) shall submit a certificate that—

- (a) 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;

- (b) 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;
 - (c) the proposed appointment is within the limits laid down by or under the authority of the Act; and
 - (d) 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."
- (2) Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in **form CRA-2**, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.
- (3) Every cost auditor appointed as such shall continue in such capacity till the expiry of one hundred and eighty days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

Provided that the cost auditor appointed under these rules may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the Cost Auditor and recording the reasons for such removal in writing;

Provided further that the Form CRA-2 to be filed with the Central Government for intimating appointment of another cost auditor shall enclose the relevant Board Resolution to the effect;

Provided also that nothing contained in this sub-rule shall prejudice the right of the cost auditor to resign from such office of the company

- (3A) 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 inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.
- (3B) The cost statements, including other statements to be annexed to the cost audit report, shall be approved by the Board of Directors before they are signed on behalf of the Board by any of the director authorised by the Board, for submission to the cost auditor to report thereon
- (4) 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**.
- (5) Every cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report, particularly any reservation or qualification contained therein.
- (6) Every company covered under these rules 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 alongwith full information and explanation on every reservation or qualification contained therein, in Form CRA-4in 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 alongwith fees specified in the Companies (Registration Offices and Fees) Rules, 2014."



FORM CRA-1

[Pursuant to rule 5(1) of the Companies (Cost Records and Audit) Rules, 2014]

Particulars relating to the Items of Costs to be included in the Books of Accounts

1. Material Costs

- (a) Proper records shall be maintained showing separately all receipts, issues and balances both in quantities and cost of each item of raw material required for the production of goods or rendering of services under reference.
- (b) The material receipt shall be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited by the taxing authorities) that can be quantified with reasonable accuracy at the time of acquisition.
- (c) Finance costs incurred in connection with the acquisition of materials shall not form part of material cost.
- (d) Self-manufactured materials or captive consumption shall be valued including direct material cost, direct employee cost, direct expenses, factory overheads, share of administrative overheads relating to production but excluding share of other administrative overheads, finance cost and marketing overheads.
- (e) Spares which are specific to an item of equipment shall not be taken to inventory, but shall be capitalized with the cost of the specific equipment. Cost of capital spares or insurance spares, whether procured with the equipment or subsequently, shall be amortised over a period, not exceeding the useful life of the equipment.
- (f) Normal loss or spoilage of material prior to reaching the factory or at places where the services are provided shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal.
- (g) Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture etc., before the material is received shall be absorbed in material cost to the extent they are normal, with corresponding adjustment in the quantity.
- (h) The forex component of imported material cost shall be converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise shall not form part of the material cost.
- (i) Any demurrage or detention charges, or penalty levied by transport or other authorities shall not form part of the cost of materials.
- (j) Subsidy or Grant or Incentive and any such payment received or receivable with respect to any material shall be reduced from cost for ascertainment of the cost of the cost object to which such amounts are related.
- (k) Issues shall be valued using appropriate assumptions on cost flow, e.g. First-in-First-out, Last-in-First-out, Weighted Average Rate. The method of valuation shall be followed on a consistent basis.
- (l) Where materials are accounted at standard cost, the price variances related to materials shall be treated as part of material cost.
- (m) Any abnormal cost shall be excluded from the material cost.
- (n) Wherever, material costs include transportation costs, determination of costs of transportation shall be governed by Para No. 9 on Determination of Cost of Transportation.
- (o) Self-manufactured components and sub-assemblies or captive consumption shall be valued including direct material cost, direct employee cost, direct expenses, factory overheads, share of administrative overheads relating to production but excluding share of other administrative overheads, finance cost and marketing overheads.

- (p) The material cost of normal scrap or defectives which are rejects shall be included in the material cost of goods manufactured. The material cost of actual scrap or defectives, not exceeding the normal shall be adjusted in the material cost of good production. Material Cost of abnormal scrap or defectives shall not be included in material cost but treated as loss after giving credit to the realisable value of such scrap or defectives.
- (q) Material costs shall be directly traced to a Cost object to the extent it is economically feasible or shall be assigned to the cost object on the basis of material quantity consumed or similar identifiable measure and valued as per above principles.
- (r) Where the material costs are not directly traceable to the cost object, the same shall be assigned on a suitable basis like technical estimates.
- (s) Where a material is processed or part manufactured by a third party according to specifications provided by the buyer, the processing or manufacturing charges payable to the third party shall be treated as part of the material cost.
- (t) Wherever part of the manufacturing operations or activity is subcontracted, the subcontract charges related to materials shall be treated as direct expenses and assigned directly to the cost object.
- (u) The cost of indirect materials shall be assigned to the various Cost objects based on a suitable basis such as actual usage or technical norms or a similar identifiable measure.
- (v) The cost of materials like catalysts, dies, tools, moulds, patterns etc., which are relatable to production over a period of time shall be amortized over the production units benefited by such cost.
- (w) The cost of indirect material with life exceeding one year shall be included in cost over the useful life of the material.

2. Employee Cost

- (a) Proper records shall be maintained in respect of employee costs in such a manner as to enable the company to book these expenses cost centre wise or department wise with reference to goods or services under reference and to furnish necessary particulars. Where the employees work in such a manner that it is not possible to identify them with any specific cost centre or service centre or department, the employees cost shall be apportioned to the cost centre or service centres or departments on equitable and reasonable basis and applied consistently.
- (b) Employee cost shall be ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all the benefits.
- (c) Bonus whether payable as a statutory minimum or on a sharing of surplus shall be treated as part of employee cost. Exgratia payable in lieu of or in addition to bonus shall also be treated as part of the employee cost.
- (d) Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute shall be considered as part of the employee cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits. Remuneration paid to non-executive directors shall not form part of employee cost but shall form part of administrative overheads.
- (e) Separation costs related to voluntary retirement, retrenchment, termination and other related matters shall be amortised over the period benefitting from such costs.
- (f) Employee cost shall not include imputed costs.
- (g) Cost of Idle time is ascertained by the idle hours multiplied by the hourly rate applicable to the idle employee or a group of employees.
- (h) Where employee cost is accounted at standard cost, variances due to normal reasons related to employee cost shall be treated as part of employee cost. Variances due to abnormal reasons shall be treated as part of abnormal cost.



- (i) Any subsidy, grant, incentive or any such payment received or receivable with respect to any employee cost shall be reduced for ascertainment of cost of the cost object to which such amounts are related.
- (j) Any abnormal cost where it is material and quantifiable shall not form part of the employee cost.
- (k) Penalties, damages paid to statutory authorities or other third parties shall not form part of the employee cost.
- (l) The cost of free housing, free conveyance and any other similar benefits provided to an employee shall be determined at the total cost of all resources consumed in providing such benefits.
- (m) Any recovery from the employee towards any benefit provided, namely, housing shall be reduced from the employee cost.
- (n) Any change in the cost accounting principles applied for the determination of the employee cost shall be made only if it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an enterprise.
- (o) Where the employee services are traceable to a cost object, such employees' cost shall be assigned to the cost object on the basis such as time consumed or number of employees engaged or other related basis or similar identifiable measure.
- (p) While determining whether a particular employee cost is chargeable to a separate cost object, the principle of materiality shall be adhered to.
- (q) Where the employee costs are not directly traceable to the cost object, the same shall be assigned on suitable basis like estimates of time based on time study.
- (r) The amortised separation costs related to voluntary retirement, retrenchment, and termination or other related matters for the period shall be treated as indirect cost and assigned to the cost objects in an appropriate manner provided that unamortised amount related to discontinue operations, shall not be treated as employee cost.
- (s) Recruitment costs, training cost and other such costs shall be treated as overheads and dealt with accordingly.
- (t) Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime.
- (u) Idle time cost shall be assigned direct to the cost object or treated as overheads depending on the economic feasibility and the specific circumstances causing such idle time.

3. Utilities

- (a) Proper records shall be maintained showing the quantity and cost of each major utility such as power, water, steam, effluent treatment and other related utilities produced and consumed by the different cost centres in such detail as to have particulars for each utility separately.
- (b) Each type of utility shall be treated as a distinct cost object.
- (c) Cost of utilities purchased shall be measured at cost of purchase including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified with reasonable accuracy at the time of acquisition.
- (d) Cost of self-generated utilities for own consumption shall comprise direct material cost, direct employee cost, direct expenses and factory overheads.
- (e) In case of utilities generated for the purpose of inter unit transfers, the distribution cost incurred for such transfers shall be added to the cost of utilities determined as above.
- (f) Cost of utilities generated for the intercompany transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads.

- (g) Cost of utilities generated for the sale to outside parties shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost, share of administrative overheads and marketing overheads. The sale value of such utilities shall also include the margin.
- (h) Finance costs incurred in connection with the utilities shall not form part of cost of utilities.
- (i) The cost of utilities shall include the cost of distribution of such utilities. The cost of distribution shall consist of the cost of delivery of utilities up to the point of consumption.
- (j) Cost of utilities shall not include imputed costs.
- (k) Where cost of utilities is accounted at standard cost, the price variances related to utilities shall be treated as part of cost of utilities and the portion of usage variances due to normal reasons shall be treated as part of cost of utilities. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.
- (l) Any subsidy or grant or incentive or any such payment received or receivable with respect to any cost of utilities shall be reduced for ascertainment of the cost to which such amounts are related.
- (m) The cost of production and distribution of utilities shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost. Cost of a Stand-by Utility shall include the committed costs of maintaining such a utility.
- (n) Any abnormal cost where it is material and quantifiable shall not form part of the cost of utilities.
- (o) Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of utilities.
- (p) Credits or recoveries relating to the utilities including cost of utilities provided to outside parties, material and quantifiable, shall be deducted from the total cost of utility to arrive at the net cost of utility.
- (q) Any change in the cost accounting principles applied for the measurement of the cost of utilities shall be made only if, it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.
- (r) While assigning cost of utilities, traceability to a cost object in an economically feasible manner shall be the guiding principle.
- (s) Where the cost of utilities is not directly traceable to cost object, it shall be assigned on the most appropriate basis.
- (t) The most appropriate basis of distribution of cost of a utility to the departments consuming services is to be derived from usage parameters.

4. Direct Expenses

- (a) Proper records shall be maintained in respect of direct expenses in such a manner as to enable the company to book these expenses cost centre wise or cost object or department wise with reference to goods or services under reference and to furnish necessary particulars.
- (b) Direct expenses incurred for the use of bought out resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited.
- (c) Other direct expenses shall be determined on the basis of amount incurred in connection therewith.
- (d) Direct expenses paid or incurred in lump-sum or which are in the nature of 'one-time' payment, shall be amortised on the basis of the estimated output or benefit to be derived from such direct expenses.
- (e) If an item of direct expenses does not meet the test of materiality, it can be treated as part of overheads.
- (f) Finance costs incurred in connection with the self-generated or procured resources shall not form part of direct expenses. Direct expenses shall not include imputed costs.
- (g) Where direct expenses are accounted at standard cost, variances due to normal reasons shall be treated as part of the direct expenses. Variances due to abnormal reasons shall not form part of the direct expenses.



- (h) Any subsidy or grant or incentive or any such payment received or receivable with respect to any direct expenses shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.
- (i) Any abnormal portion of the direct expenses where it is material and quantifiable shall not form part of the direct expenses.
- (j) Penalties, damages paid to statutory authorities or other third parties shall not form part of the direct expenses.
- (k) Credits or recoveries relating to the direct expenses, material and quantifiable, shall be deducted to arrive at the net direct expenses.
- (l) Any change in the cost accounting principles applied for the measurement of the direct expenses shall be made only if, it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.
- (m) Direct expenses that are directly traceable to the cost object shall be assigned to that cost object.

5. Repairs and Maintenance

- (a) Proper records showing the expenditure incurred by the workshop, tool room and on repairs and maintenance in the various cost centres or departments shall be maintained under different heads.
- (b) Repairs and maintenance cost shall be the aggregate of direct and indirect cost relating to repairs and maintenance activity. Direct cost shall include the cost of materials, consumable stores, spares, manpower, equipment usage, utilities and other identifiable resources consumed in such activity. Indirect cost shall include the cost of resources common to various repairs and maintenance activities such as manpower, equipment usage and other costs allocable to such activities.
- (c) Cost of in-house repairs and maintenance activity shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity.
- (d) Cost of repairs and maintenance activity carried out by outside contractors inside the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs.
- (e) Cost of repairs and maintenance jobs carried out by contractor at its premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of other resources provided to the contractors.
- (f) Cost of repairs and maintenance jobs carried out by outside contractors shall include charges made by the contractor and cost of own materials, consumable stores, spares, manpower, equipment usage, utilities and other costs used in such jobs.
- (g) Each type of repairs and maintenance shall be treated as a distinct activity, if material and identifiable.
- (h) Cost of repairs and maintenance activity shall be measured for each major asset category separately.
- (i) Cost of spares replaced which do not enhance the future economic benefits from the existing asset beyond its previously assessed standard of performance shall be included under repairs and maintenance cost.
- (j) High value spare, when replaced by a new spare and is reconditioned, which is expected to result in future economic benefits, the same shall be taken into stock. Such a spare shall be valued at an amount that measures its service potential in relation to a new spare which amount shall not exceed the cost of reconditioning the spare. The difference between the total of the cost of the new spare and the reconditioning cost and the value of the reconditioned spare shall be treated as repairs and maintenance cost.
- (k) The cost of major overhaul shall be amortised on a rational basis.
- (l) Finance costs incurred in connection with the repairs and maintenance activities shall not form part of Repairs and maintenance costs.

- (m) Repairs and maintenance costs shall not include imputed costs.
- (n) Price variances related to repairs and maintenance, where standard costs are in use, shall be treated as part of repairs and maintenance cost. The portion of usage variances attributable to normal reasons shall be treated as part of repairs and maintenance cost. Usage variances attributable to abnormal reasons shall be excluded from repairs and maintenance cost.
- (o) Subsidy or Grant or Incentive or amount of similar nature received or receivable with respect to repairs and maintenance activity, if any, shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.
- (p) Any repairs and maintenance cost resulting from some abnormal circumstances, namely, major fire, explosion, flood and similar events, if material and quantifiable, shall not form part of the repairs and maintenance cost.
- (q) Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the repairs and maintenance cost.
- (r) Credits or recoveries relating to the repairs and maintenance activity, material and quantifiable, shall be deducted to arrive at the net repairs and maintenance cost.
- (s) Any change in the cost accounting principles applied for the measurement of the repairs and maintenance cost shall be made only if, it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.
- (t) Repairs and maintenance costs shall be traced to a cost object to the extent economically feasible.
- (u) Where the repairs and maintenance cost is not directly traceable to cost object, it shall be assigned based on either of the following the principles of (1) Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost and (2) Benefits received – overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.
- (v) If the repairs and maintenance cost (including the share of the cost of reciprocal exchange of services) is shared by several cost objects, the related cost shall be measured as an aggregate and distributed among the cost objects.

6. Fixed Assets and depreciation

- (a) Proper and adequate records shall be maintained for assets used for production of goods or rendering of services under reference in respect of which depreciation has to be provided for. These records shall, inter-alia, indicate grouping of assets under each good or service, the cost of acquisition of each item of asset including installation charges, date of acquisition and rate of depreciation.
- (b) Depreciation and amortisation shall be measured based on the depreciable amount and the useful life. The residual value of an intangible asset shall be assumed to be zero unless:
 - (i) there is a commitment by a third party to purchase the asset at the end of its useful life; or
 - (ii) there is an active market for the asset and:
 - a. residual value can be determined by reference to that market; and
 - b. it is probable that such a market will exist at the end of the asset's useful life.
 - c. The residual value of a fixed asset shall be considered as zero if the entity is unable to estimate the same with reasonable accuracy.
- (c) The minimum amount of depreciation to be provided shall not be less than the amount calculated as per principles and methods as prescribed by any law or regulations applicable to the entity and followed by it.
- (d) In case of regulated industry the amount of depreciation shall be the same as prescribed by the concerned regulator.
- (e) While estimating the useful life of a depreciable asset, consideration shall be given to the following factors:
 - (i) Expected physical wear and tear;



- (ii) Obsolescence; and
 - (iii) Legal or other limits on the use of the asset.
- (f) The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset.
 - (g) If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a re-acquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.
 - (h) The useful life of an intangible asset, in any situation, shall not exceed 10 years from the date it is available for use.
 - (i) Depreciation shall be considered from the time when a depreciable asset is first put into use. An asset which is used only when the need arises but is always held ready for use. Example: fire extinguisher, stand by generator, safety equipment shall be considered to be an asset in use. Depreciable assets shall be considered to be put into use when commercial production of goods and services commences.
 - (j) Depreciation on an asset which is temporarily retired from production of goods and services shall be considered as abnormal cost for the period when the asset is not in use.
 - (k) Depreciation of any addition or extension to an existing depreciable asset which becomes an integral part of that asset shall be based on the remaining useful life of that asset.
 - (l) Depreciation of any addition or extension to an existing depreciable asset which retains a separate identity and is capable of being used after the expiry of the useful life of that asset shall be based on the estimated useful life of that addition or extension.
 - (m) The impact of higher depreciation due to revaluation of assets shall not be assigned to cost object.
 - (n) Impairment loss on assets shall be excluded from cost of production.
 - (o) The method of depreciation used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
 - (p) An entity can use any of the methods of depreciation to assign depreciable amount of an asset on a systematic basis over its useful life, namely, Straight-line method; Diminishing balance method; and Units of production method, etc.
 - (q) The method of amortisation of intangible asset shall reflect the pattern in which the economic benefits accrue to entity.
 - (r) The methods and rates of depreciation applied shall be reviewed at least annually and, if there has been a change in the expected pattern of consumption or loss of future economic benefits, the method applied shall be changed to reflect the changed pattern.
 - (s) Spares purchased specifically for a particular asset, or class of assets, and which would become redundant if that asset or class of asset was retired or use of that asset was discontinued, shall form part of that asset. The depreciable amount of such spares shall be allocated over the useful life of the asset.
 - (t) Cost of small assets shall be written off in the period in which they were purchased as per the accounting policy of the entity.
 - (u) Depreciation of an asset shall not be considered in case cumulative depreciation exceeds the original cost of the asset, net of residual value.
 - (v) Where depreciation for an addition of an asset is measured on the basis of the number of days for which the asset was used for the preparation and presentation of financial statements, depreciation of the asset for assigning to cost of object shall be measured in relation to the period, the asset actually utilized.

- (w) Depreciation shall be traced to the cost object to the extent economically feasible.
- (x) Where the depreciation is not directly traceable to cost object, it shall be assigned based on either of the following two principles; namely:-
 - (i) **Cause and Effect** - Cause is the process or operation or activity and effect is the incurrence of cost and
 - (ii) **Benefits received** - overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.

7. Overheads

- (a) Proper records shall be maintained for various items of indirect expenses comprising overheads pertaining to goods or services under reference. These expenses shall be analysed, classified and grouped according to functions.
- (b) Overheads representing procurement of resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), taxes and duties refundable or to be credited.
- (c) Overheads other than those referred to above shall be determined on the basis of cost incurred in connection therewith.
- (d) Any abnormal cost where it is material and quantifiable shall not form part of the overheads.
- (e) Finance costs incurred in connection with procured or self-generated resources shall not form part of overheads.
- (f) Overheads shall not include imputed cost.
- (g) Overhead variances attributable to normal reasons shall be treated as part of overheads. Overhead variances attributable to abnormal reasons shall be excluded from overheads.
- (h) Any subsidy or grant or incentive or amount of similar nature received or receivable with respect to overheads shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.
- (i) Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the overheads.
- (j) Credits or recoveries relating to the overheads, material and quantifiable, shall be deducted from the total overhead to arrive at the net overheads. Where the recovery exceeds the total overheads, the balance recovery shall be treated as other income.
- (k) Any change in the cost accounting principles applied for the measurement of the overheads shall be made only if, it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an entity.
- (l) While assigning overheads, traceability to a cost object in an economically feasible manner shall be the guiding principle. The cost which can be traced directly to a cost object shall be directly assigned.
- (m) Overheads shall be classified according to functions, viz., works, administration, selling and distribution, head office, corporate etc.
- (n) Assignment of overheads to the cost objects shall be based on either of the following two principles; (1) Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost and (2) Benefits received – overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.
- (o) The variable production overheads shall be absorbed to products or services based on actual capacity utilisation.



- (p) The fixed production overheads shall be absorbed based on the normal capacity.
- (q) Assignment of Administration Overheads shall be in accordance with para No. 8.
- (r) Marketing overheads that can be identified to a product or service shall be assigned to that product or service.
- (s) Marketing overheads that cannot be identified to a product or service shall be assigned to the products or services on the most appropriate basis.

8. Administrative Overheads

- (a) Administrative overheads shall be the aggregate of cost of resources consumed in activities relating to general management and administration of an organisation.
- (b) In case of leased assets, if the lease is an operating lease, the entire rentals shall be included in the administrative overheads. If the lease is a financial lease, the finance cost portion shall be segregated and treated as part of finance costs.
- (c) The cost of software (developed in house, purchased, licensed or customised), including up-gradation cost shall be amortised over its estimated useful life.
- (d) The cost of administrative services procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited.
- (e) Any subsidy or grant or incentive or any amount of similar nature received or receivable with respect to any Administrative overheads shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.
- (f) Administrative overheads shall not include any abnormal administrative cost.
- (g) Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the administrative overheads.
- (h) Credits or recoveries relating to the administrative overheads including those rendered without any consideration, material and quantifiable, shall be deducted to arrive at the net administrative overheads.
- (i) Any change in the cost accounting principles applied for the measurement of the administrative overheads shall be made only if it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.
- (j) While assigning administrative overheads, traceability to a cost object in an economically feasible manner shall be the guiding principle.
- (k) Assignment of administrative overheads to the cost objects shall be based on either of the following two principles; namely:-
 - (i) **Cause and Effect** - Cause is the process or operation or activity and effect is the incurrence of cost.
 - (ii) **Benefits received** - overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.

9. Transportation Cost

- (a) Proper records shall be maintained for recording the actual cost of transportation showing each element of cost such as freight, cartage, transit insurance and others after adjustment for recovery of transportation cost. Abnormal costs relating to transportation, if any, are to be identified and recorded for exclusion of computation of average transportation cost.
- (b) In case of a manufacturer having his own transport fleet, proper records shall be maintained to determine the actual operating cost of vehicles showing details of various elements of cost, such as salaries and wages of driver, cleaners and others, cost of fuel, lubricant grease, amortized cost of tyres and battery, repairs

and maintenance, depreciation of the vehicles, distance covered and trips made, goods hauled and transported to the depot.

- (c) In case of hired transport charges incurred for despatch of goods, complete details shall be recorded as to date of despatch, type of transport used, description of the goods, destination of buyer, name of consignee, challan number, quantity of goods in terms of weight or volume, distance involved, amount paid and other related details.
- (d) Records shall be maintained separately for inward and outward transportation cost specifying the details particulars of goods despatched, name of supplier or recipient, amount of freight etc.
- (e) Separate records shall be maintained for identification of transportation cost towards inward movement of material (procurement) and transportation cost of outward movement of goods removed or sold for both home consumption and export.
- (f) Records for transportation cost from factory to depot and thereafter shall be maintained separately.
- (g) Records for transportation cost for carrying any material or product to job-workers place and back shall be maintained separately so as include the same in the transaction value of the product.
- (h) Records for transportation cost for goods involved exclusively for trading activities shall be maintained separately and the same shall not be included for claiming any deduction for calculating assessable value excisable goods cleared for home consumption.
- (i) Records of transportation cost directly allocable to a particular category of products shall be maintained separately so that allocation can be made.
- (j) For common transportation cost, both for own fleet or hired ones, proper records for basis of apportionment shall be maintained.
- (k) Records for transportation cost for exempted goods, excisable goods cleared for export shall be maintained separately.
- (l) Separate records of cost for mode of transportation other than road like ship or air are to be maintained, which shall be included in total cost of transportation.
- (m) Inward transportation costs shall form the part of the cost of procurement of materials which shall be identified for proper allocation or apportionment to the materials or products.
- (n) Outward transportation cost shall form the part of the cost of sale and shall be allocated or apportioned to the materials and goods on a suitable basis.
- (o) The following basis shall be used, in order of priority, for apportionment of outward transportation cost depending upon the nature of products, unit of measurement followed and type of transport used, namely:-
 - (i) Weight;
 - (ii) Volume of goods;
 - (iii) Tonne-Km;
 - (iv) Unit or Equivalent unit;
 - (v) Value of goods;
 - (vi) Percentage of usage of space.
- (p) Once a basis of apportionment is adopted, the same shall be followed consistently.
- (q) For determining the transportation cost per unit, distance shall be factored in to arrive at weighted average cost.
- (r) Abnormal and non recurring cost shall not be a part of transportation cost.



10. Royalty and Technical Know-how

- (a) Adequate records shall be maintained showing royalty or technical know-how fee including other recurring or non-recurring payments of similar nature, if any, made for the goods or services under reference to collaborators or technology suppliers in terms of agreements entered into with them.
- (b) Royalty and technical know-how Fee paid or incurred in lump-sum or which are in the nature of 'one-time' payment, shall be amortised on the basis of the estimated output or benefit to be derived from the related asset. Amortisation of the amount of royalty or technical know-how fee paid for which the benefit is ensued in the current or future periods shall be determined based on the production or service volumes estimated for the period over which the asset is expected to benefit the entity.
- (c) Amount of the royalty and technical know-how fee shall not include finance costs and imputed costs.
- (d) Any subsidy or grant or incentive or any such payment received or receivable with respect to amount of royalty and technical know-how fee shall be reduced to measure the amount of royalty and technical know-how fee.
- (e) Penalties, damages paid to statutory authorities or other third parties shall not form part of the amount of royalty and technical know-how fee.
- (f) Credits or recoveries relating to the amount royalty and technical know-how fee, material and quantifiable, shall be deducted to arrive at the net amount of royalty and technical know-how fee.
- (g) Any change in the cost accounting principles applied for the measurement of the amount of royalty and technical knowhow fee shall be made only if, it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.
- (h) Royalty and technical know-how fee that is directly traceable to a cost object shall be assigned to that cost object. In case such fee is not directly traceable to a cost object then it shall be assigned on any of the following basis, namely:-
 - (i) Units produced;
 - (ii) Units sold; or
 - (iii) Sales value.
- (i) The amount of royalty fee paid for mining rights shall form part of the cost of material.
- (j) The amount of royalty and technical know-how fee shall be assigned on the nature or purpose of such fee. The amount of royalty and technical know-how fee related to product or process know how shall be treated as cost of production; if related to trademarks or brands shall be treated as cost of sales.

11. Research and Development Expenses

- (a) Research and development costs shall include all the costs that are directly traceable to research or development activities or that can be assigned to research and development activities strictly on the basis of (a) cause and effect or (b) benefits received. Such costs shall include the following elements, namely:-
 - (i) the cost of materials and services consumed in research and development activities.
 - (ii) cost of bought out materials and hired services as per invoice or agreed price including duties and taxes directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited.
 - (iii) the salaries, wages and other related costs of personnel engaged in research and development activities;
 - (iv) the depreciation of equipment and facilities, and other tangible assets, and amortisation of intangible assets to the extent that they are used for research and development activities;
 - (v) overhead costs, other than general administrative costs, related to research and development activities.

- (vi) costs incurred for carrying out research and development activities by other entities and charged to the entity; and
 - (vii) expenditure incurred in securing copyrights or licences;
 - (viii) expenditure incurred for developing computer software;
 - (ix) costs incurred for the design of tools, jigs, moulds and dies;
 - (x) other costs that can be directly attributed to research and development activities and can be identified with specific projects.
- (b) Subsidy or grant or incentive or amount of similar nature received or receivable with respect to research and development activity, if any, shall be reduced from the cost of such research, and development activity.
 - (c) Any abnormal cost where it is material and quantifiable shall not form part of the research and development cost.
 - (d) Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the research and development cost.
 - (e) Research and development costs shall not include imputed costs.
 - (f) Credits or recoveries relating to research and development cost, if material and quantifiable, including from the sale of output produced from the research and development activity shall be deducted from the research and development cost.
 - (g) Research and development costs attributable to a specific cost object shall be assigned to that cost object directly. Research and development costs that are not attributable to a specific product or process shall not form part of the product cost.
 - (h) Development cost which results in the creation of an intangible asset shall be amortised over its useful life. Assignment of development costs shall be based on the principle of "benefits received".
 - (i) Research and development costs incurred for the development and improvement of an existing process or product shall be included in the cost of production. In case the Research and development activity related to the improvement of an existing process or product continues for more than one accounting period, the cost of the same shall be accumulated and amortised over the estimated period of use of the improved process or estimated period over which the improved product shall be produced by the entity after the commencement of commercial production, as the case may be, if the improved process or product is distinctly different from the existing process or product and the product is marketed as a new product. The amount allocated to a particular period shall be included in the cost of production of that period. If the expenditure is only to improve the quality of the existing product or minor modifications in attributes, the principle shall not be applied.
 - (j) Development costs attributable to a saleable service namely, providing technical know-how to outside parties shall be accumulated separately and treated as cost of providing the service.

12. Quality control expenses

- (a) Adequate records shall be maintained to indicate the expenses incurred in respect of quality control department or cost centre or service centre for goods or services under reference. Where these services are also utilized for other goods or services of the company, the basis of apportionment to goods or services under reference and to other goods or services shall be on equitable and reasonable basis and applied consistently.
- (b) Quality control cost incurred in-house shall be the aggregate of the cost of resources consumed in the quality control activities of the entity. The cost of resources procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), taxes and duties refundable or to be credited by the Tax Authorities. Such cost shall include cost of conformance to quality, namely, (a) prevention cost; and (b) appraisal cost.
- (c) Identification of quality control costs shall be based on traceability in an economically feasible manner.



- (d) Quality control costs other than those referred to above shall be determined on the basis of amount incurred in connection therewith.
- (e) Finance costs incurred in connection with the self-generated or procured resources shall not form part of quality control cost.
- (f) Quality control costs shall not include imputed costs.
- (g) Any Subsidy or grant or incentive or any such payment received or receivable with respect to any quality control cost shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.
- (h) Any abnormal portion of the quality control cost where it is material and quantifiable shall not form part of the cost of quality control.
- (i) Penalties, damages paid to statutory authorities or other third parties shall not form part of the quality control cost.
- (j) Any change in the cost accounting principles applied for the measurement of the quality control cost shall be made only if, it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.
- (k) Quality control cost that is directly traceable to the cost object shall be assigned to that cost object. Assignment of quality control cost to the cost objects shall be based on benefits received by them on the principles, namely:-
 - (i) **Cause and effect** - Cause is the process or operation or activity and effect is the incurrence of cost and
 - (ii) **Benefits received** - overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.

13. Pollution control expenses

- (a) Adequate records shall be maintained to indicate the expenses incurred in respect of pollution control. The basis of apportionment to goods or services under reference and to other goods or services shall be on equitable and reasonable basis and applied consistently.
- (b) Pollution control costs shall be the aggregate of direct and indirect cost relating to pollution control activity. Direct cost shall include the cost of materials, consumable stores, spares, manpower, equipment usage, utilities, resources for testing and certification and other identifiable resources consumed in activities such as waste processing, disposal, remediation and others. Indirect cost shall include the cost of resources common to various pollution control activities such as pollution control registration and such like expenses.
- (c) Costs of pollution control which are internal to the entity shall be accounted for when incurred. They shall be measured at the historical cost of resources consumed.
- (d) Future remediation or disposal costs which are expected to be incurred with reasonable certainty as part of onerous contract or constructive obligation, legally enforceable shall be estimated and accounted based on the quantum of pollution generated in each period and the associated cost of remediation or disposal in future.
- (e) Contingent future remediation or disposal costs e.g. those likely to arise on account of future legislative changes on pollution control shall not be treated as cost until the incidence of such costs become reasonably certain and can be measured.
- (f) External costs of pollution which are generally the costs imposed on external parties including social costs are difficult to estimate with reasonable accuracy and are excluded from general purpose cost statements.
- (g) Social costs of pollution are measured by economic models of cost measurement. The cost by way of compensation by the polluting entity either under future legislation or under social pressure cannot be quantified by traditional models of cost measurement. They are best kept out of general purpose cost statements.

- (h) Cost of in-house pollution control activity shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity.
- (i) Cost of pollution control activity carried out by outside contractors inside the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs.
- (j) Cost of pollution control jobs carried out by contractor at its premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of other resources provided to the contractors.
- (k) Cost of pollution control jobs carried out by outside contractors shall include charges made by the contractor and cost of own materials, consumable stores, spares, manpower, equipment usage, utilities and other costs used in such jobs.
- (l) Each type of pollution control namely, water, air, soil pollution shall be treated as a distinct activity, if material and identifiable.
- (m) Finance costs incurred in connection with the pollution control activities shall not form part of pollution control costs.
- (n) Pollution control costs shall not include imputed costs.
- (o) Price variances related to pollution control, where standard costs are in use, shall be treated as part of pollution control cost. The portion of usage variances attributable to normal reasons shall be treated as part of pollution control cost. Usage variances attributable to abnormal reasons shall be excluded from pollution control cost.
- (p) Subsidy or grant or incentive or amount of similar nature received or receivable with respect to Pollution control activity, if any, shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.
- (q) Any Pollution control cost resulting from abnormal circumstances, if material and quantifiable, shall not form part of the pollution control cost.
- (r) Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the pollution control cost.
- (s) Credits or recoveries relating to the pollution control activity, material and quantifiable, shall be deducted to arrive at the net pollution control cost.
- (t) Research and development cost to develop new process, new products or use of new materials to avoid or mitigate pollution shall be treated as research and development costs and not included under pollution control costs. Development costs incurred for commercial development of such product, process or material shall be included in pollution control costs.
- (u) Any change in the cost accounting principles applied for the measurement of the pollution control cost shall be made only if, it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.
- (v) Pollution Control costs shall be traced to a cost object to the extent economically feasible.
- (w) Direct costs of pollution control such as treatment and disposal of waste shall be assigned directly to the product, where traceable economically.
- (x) Where these costs are not directly traceable to the product but are traceable to a process which causes pollution, the costs shall be assigned to the products passing through the process based on the quantity of the pollutant generated by the product.
- (y) Where the pollution control cost is not directly traceable to cost object, it shall be treated as overhead and assigned based on either of the following two principles; namely:-
 - (1) **Cause and Effect** - Cause is the process or operation or activity and effect is the incurrence of cost and



(2) Benefits received - overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.

14. Service department expenses

- (a) Proper records shall be maintained in respect of service departments, that is, cost centres which primarily provides auxiliary services across the enterprise, to indicate expenses incurred in respect of each such service cost centre like engineering, work shop, designing, laboratory, safety, transport, computer cell, welfare and other related centres.
- (b) Each identifiable service cost centre shall be treated as a distinct cost object for measurement of the cost of services subject to the principle of materiality.
- (c) Cost of service cost centre shall be the aggregate of direct and indirect cost attributable to services being rendered by such cost centre.
- (d) Cost of in-house services shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such service.
- (e) Cost of other resources shall include related overheads.
- (f) Cost of services rendered by contractors within the facilities of the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources provided to the contractors for such services.
- (g) Cost of services rendered by contractors at their premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of resources provided to the contractors.
- (h) Cost of services for the purpose of inter unit transfers shall also include distribution costs incurred for such transfers.
- (i) Cost of services for the purpose of inter-company transfers shall also include distribution cost incurred for such transfers and administrative overheads.
- (j) Cost of services rendered to outside parties shall also include distribution cost incurred for such transfers, administrative overheads and marketing overheads.
- (k) Finance costs incurred in connection with the service cost Centre shall not form part of the cost of Service Cost Centre.
- (l) The cost of service cost centre shall not include imputed costs.
- (m) Where the cost of service cost centre is accounted at standard cost, the price and usage variances related to the services cost Centre shall be treated as part of cost of services. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.
- (n) Any Subsidy or grant or incentive or any such payment received or receivable with respect to any service cost centre shall be reduced for ascertainment of the cost to which such amounts are related.
- (o) The cost of production and distribution of the service shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost. Cost of a stand-by service shall include the committed costs of maintaining such a facility for the service.
- (p) Any abnormal cost where it is material and quantifiable shall not form part of the cost of the service cost centre.
- (q) Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of the service cost centre.

- (r) Credits or recoveries relating to the service cost centre including charges for services rendered to outside parties, material and quantifiable, shall be reduced from the total cost of that service cost centre.
- (s) Any change in the cost accounting principles applied for the measurement of the cost of Service cost centre shall be made, only if it is required by law or a change would result in a more appropriate preparation or presentation of cost statements of an enterprise.
- (t) While assigning cost of services, traceability to a cost object in an economically feasible manner shall be the guiding principle.
- (u) Where the cost of services rendered by a service cost centre is not directly traceable to a cost object, it shall be assigned on the most appropriate basis.
- (v) The most appropriate basis of distribution of cost of a service cost centre to the cost centres consuming services is to be derived from logical parameters related to the usage of the service rendered. The parameter shall be equitable, reasonable and consistent.

15. Packing expenses

- (a) Proper records shall be maintained separately for domestic and export packing showing the quantity and cost of various packing materials and other expenses incurred on primary or secondary packing indicating the basis of valuation.
- (b) The packing material receipts shall be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified at the time of acquisition.
- (c) Finance costs directly incurred in connection with the acquisition of packing material shall not form part of packing material cost.
- (d) Self-manufactured packing materials shall be valued including direct material cost, direct employee cost, direct expenses, job charges, factory overheads including share of administrative overheads comprising factory management and administration and share of research and development cost incurred for development and improvement of existing process or product.
- (e) Normal loss or spoilage of packing material prior to receipt in the factory shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal.
- (f) The forex component of imported packing material cost shall be converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise shall not form part of the packing material cost.
- (g) Any demurrage, detention charges or penalty levied by the transport agency or any authority shall not form part of the cost of packing materials.
- (h) Any subsidy or grant or incentive or any such payment received or receivable with respect to packing material shall be reduced for ascertainment of the cost to which such amounts are related.
- (i) Issue of packing materials shall be valued using appropriate assumptions on cost flow, namely, First In First Out, Last In First Out, weighted average rate. The method of valuation shall be followed on a consistent basis.
- (j) Wherever, packing material costs include transportation costs, the determination of costs of transportation shall be in accordance with para No. 9 on determination of cost of transportation.
- (k) Packing material costs shall not include imputed costs.
- (l) Where packing materials are accounted at standard cost, the price variances related to such materials shall be treated as part of packing material cost and the portion of usage variances due to normal reasons shall be treated as part of packing material cost. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.
- (m) The normal loss arising from the issue or consumption of packing materials shall be included in the packing materials cost.



- (n) Any abnormal cost where it is material and quantifiable shall be excluded from the packing material cost.
- (o) The credits or recoveries in the nature of normal scrap arising from packing materials if any, shall be deducted from the total cost of packing materials to arrive at the net cost of packing materials.
- (p) Packing material costs shall be directly traced to a cost object to the extent it is economically feasible.
- (q) Where the packing material costs are not directly traceable to the cost object, these may be assigned on the basis of quantity consumed or similar measures like technical estimates.
- (r) The packing material cost of reusable packing shall be assigned to the cost object taking into account the number of times or the period over which it is expected to be reused.
- (s) Cost of primary packing materials shall form part of the cost of production.
- (t) Cost of secondary packing materials shall form part of distribution overheads.

16. Interest and financing charges

- (a) Interest and financing charges are costs incurred by an enterprise in connection with the borrowing of fund or other costs which in effect represent payment for the use of non- equity fund.
- (b) Interest and financing charges incurred shall be identified for-
 - (i) acquisition or construction or production of qualifying assets including fixed assets; and
 - (ii) other finance costs for production of goods or operations or services rendered which cannot be classified as qualifying assets.
- (c) Interest and financing charges directly attributable to the acquisition or construction or production of a qualifying asset shall be included in the cost of the asset.
- (d) Interest and financing charges shall not include imputed costs.
- (e) Subsidy or grant or incentive or amount of similar nature received or receivable with respect to Interest and Financing Charges if any, shall be reduced to ascertain the net interest and financing charges.
- (f) Penal Interest for delayed payment, fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the interest and financing charges. In case the company delays the payment of statutory dues beyond the stipulated date, interest paid for delayed payment shall not be treated as penal interest.
- (g) Interest paid for or received on investment shall not form part of the other financing charges for production of goods or operations or services rendered;
- (h) Assignment of interest and financing charges to the cost objects shall be based on either of the following two principles; namely:-
 - (1) **Cause and Effect** - Cause is the process or operation or activity and effect is the incurrence of cost and
 - (2) **Benefits received** - to be apportioned to the various cost objects in proportion to the benefits received by them.

17. Any other item of cost

Proper records shall be maintained for any other item of cost being indispensable and considered necessary for inclusion in cost records for calculating cost of production of goods or rendering of services, cost of sales, margin in total and per unit of the goods or services under reference.

18. Capacity determination

- (a) Capacity shall be determined in terms of units of production or equivalent machine or man hours.
- (b) Installed capacity is determined based on-
 - (i) manufacturers' Technical specifications;
 - (ii) capacities of individual or interrelated production centres;
 - (iii) operational constraints or capacity of critical machines; or
 - (iv) number of shifts

- (c) In case manufacturers' technical specifications are not available, the estimates by technical experts on capacity under ideal conditions shall be considered for determination of installed capacity. In case any production facility is added or discarded the installed capacity shall be reassessed from the date of such addition or discard. In case the same is reassessed as per direction of the Government, it shall be in accordance with the principles laid down in the said directives. In case of improvement in the production process, the installed capacity shall be reassessed from the date of such improvement.
- (d) Normal capacity shall be determined vis-a-vis installed capacity after carrying out adjustments for
 - (i) holidays, normal shut down days and normal idle time;
 - (ii) normal time lost in batch change over;
 - (iii) time lost due to preventive maintenance and normal break downs of equipment's;
 - (iv) loss in efficiency due to ageing of the equipment; or
 - (v) number of shifts;
- (e) Capacity utilization is actual production measured as a percentage of installed capacity.

19. Work-in-progress and finished stock

The method followed for determining the cost of work-in-progress and finished stock of the goods and for services under delivery or in-process shall be appropriate and shall be indicated in the cost records so as to reveal the cost element that have been taken into account in such computation. All conversion costs incurred in bringing the inventories to their present location and condition shall be taken into account while computing the cost of work-in-progress and finished stock. The method adopted for determining the cost of work-in progress and finished goods shall be followed consistently.

20. Captive consumption

If the goods or services under reference are used for captive consumption, proper records shall be maintained showing the quantity and cost of each such goods or services transferred to other departments or cost centres or units of the company for self-consumption and sold to outside parties separately.

21. By-Products and Joint Products

- (a) Proper records shall be maintained for each item of by-product, if any, produced showing the receipt, issues and balances, both in quantity and value. The basis adopted for valuation of by-product for giving credit to the respective process shall be equitable and consistent and shall be indicated in cost records. Records showing the expenses incurred on further processing, if any, and actual sales realisation of by-product shall be maintained. The proper records shall be maintained in respect of credits or recoveries from the disposal of by-products.
- (b) Proper records shall be maintained the cost up to the point of separation of products or services shall be apportioned to joint products or services on reasonable and equitable basis and shall be applied consistently. The basis on which such joint costs are apportioned to different products or services arising from the process shall be indicated in the cost records. Proper records shall be maintained in respect credits or recoveries from the disposal of joint products or services.

22. Adjustment of cost variances.

Where the company maintains cost records on any basis other than actual such as standard costing, the records shall indicate the procedure followed by the company in working out the cost of the goods or services under such system. The cost variances shall be shown against separate heads and analyzed into material, labour, overheads and further segregated into quantity, price and efficiency variances. The method followed for adjusting the cost variances in determining the actual cost of the goods or services shall be indicated clearly in the cost records. The reasons for the variances shall be duly explained in the cost records and statements.



23. Reconciliation of cost and financial accounts

The cost statements shall be reconciled with the financial statements for the financial year specifically indicating the expenses or incomes not considered in the cost records or statements so as to ensure accuracy and to adjust the profit of the goods or services under reference with the overall profit of the company. The variations, if any, shall be clearly indicated and explained.

24. Related party transactions

- (a) Related Party means related party as defined under clause (76) of section 2 of the Companies Act, 2013 (18 of 2013).
- (b) "Normal" price means price charged for comparable and similar products in the ordinary course of trade and commerce where the price charged in the sole consideration of sale and such sale is not made to a related party. Normal price can be construed to be a price at which two unrelated and non-desperate parties would agree to a transaction and where such transaction is not clouded due to the proximity of the parties to the transaction and free from influence though the parties may have shared interest.
- (c) The basis adopted to determine Normal price shall be classified as under:
 - (i) Comparable uncontrolled price method;
 - (ii) Resale price method;
 - (iii) Cost plus method;
 - (iv) Profit split method;
 - (v) Transactional net margin method; or
 - (vi) Any other method, to be specified.
- (d) In respect of related party transactions or supplies made or services rendered by a company to a company termed "related party relationship" and vice-a-versa, records shall be maintained showing contracts entered into, agreements or understanding reached in respect of -
 - (i) purchase and sale of raw materials, finished goods, rendering of services, process materials and rejected goods including scraps and other related materials;
 - (ii) utilisation of plant facilities and technical know-how;
 - (iii) supply of utilities and any other services;
 - (iv) administrative, technical, managerial or any other consultancy services;
 - (v) purchase and sale of capital goods including plant and machinery; and
 - (vi) any other payment related to the production of goods or rendering of services under reference.
- (e) These records shall also indicate the basis followed for arriving at the rates charged or paid for such goods or services so as to enable determination of the reasonableness of such rates in so far as they are in any way related to goods or services under reference.

25. Expenses or incentives on exports

- (a) Proper records showing the expenses incurred on the export sales, if any, of the goods or services under reference shall be separately maintained so that the cost of export sales can be determined correctly. Separate cost statements shall be prepared for goods or services exported giving details of export expenses incurred or incentive earned.
- (b) Proper records shall be maintained giving the details of export commitments license-wise and the fulfillment of these commitments giving the reasons for non-compliance, if any. In case, duty free imports are made, the cost statements shall reflect this fact. If the duty free imports have been made after actual production, the statement shall reflect this fact also.

26. Production Records

Quantitative records of all finished goods (packed or unpacked) or services rendered showing production, issues for sales and balances of different type of the goods or services under reference, shall be maintained. The quantitative details of production of goods or services rendered shall be maintained separately for self-produced, third party on job work, loan license basis etc.

27. Sales records

Separate details of sales shall be maintained for domestic sales at control price, domestic sales at market price, export sales under advance license, export sales under other obligations, export sales at market price, and sales to related party or inter unit transfer. In case of services details of domestic delivery or sales at control price, domestic delivery or sales at market price, export delivery or sales under advance license, export delivery or sales under other obligations, export delivery or sales at market price, and delivery or sales to related party or inter unit transfer. Such details shall be maintained separately for each plant or unit wise or service center wise for total as well as per unit sales realization.

28. Cost statements

- (a) Cost statements (monthly, quarterly and annually) showing quantitative information in respect of each good or service under reference shall be prepared showing details of available capacity, actual production, production as per excise records, capacity utilization (in-house), stock purchased for trading, stock and other adjustments, quantity available for sale, wastage and actual sale during current financial year and previous year.
- (b) Such statements shall also include details in respect of all major items of costs constituting cost of production of goods or services, cost of sales of goods or services and margin in total as well as per unit of the goods or services. The goods or services emerging from a process, which forms raw material or an input material or service for a subsequent process, shall be valued at the cost of production or cost of service up to the previous stage.
- (c) Cost Statements (monthly, quarterly and annually) in respect of reconciliation of indirect taxes showing details of total clearances of goods or services, assessable value, duties or taxes paid, CENVAT or VAT or Service Tax credit utilized, duties or taxes recovered and interest or penalty paid.
- (d) If the company is operating more than one plant, factory or service centre, separate cost statements as specified above shall be prepared in respect of each plant, factory or service centre.
- (e) Any other statement or information considered necessary for suitable presentation of costs and profitability of goods or services produced by the company shall also be prepared.

29. Statistical Records

- (a) The records regarding available machine hours or direct labour hours in different production departments and actually utilized shall be maintained for production of goods or rendering of services under reference and shortfall suitably analyzed. Suitable records for computation of idle time of machines or labour shall also be maintained and analyzed.
- (b) Proper records shall be maintained to enable the company to identify the capital employed, net fixed assets and working capital separately for the production of goods or rendering of services under reference and other goods or services to the extent such elements are separately identifiable. Non-identifiable items shall be allocated on a suitable and reasonable basis to different goods or services. Fresh investments on fixed assets for production of goods or rendering of services under reference that have not contributed to the production of goods or rendering of services during the relevant period or year shall be indicated in the cost records. The records shall, in addition, show assets added as replacement and those added for increasing existing capacity.

30. Records of Physical Verification

Records of physical verification may be maintained in respect of all items held in the stock such as raw materials, process materials, packing materials, consumables stores, machinery spares, chemicals, fuels, finished goods and fixed assets etc. Reasons for shortages or surplus arising out of such verifications and the method followed for adjusting the same in the cost of the goods or services shall be indicated in the records.



FORM NO. CRA-2

[Pursuant to section 148(3) of Companies Act, 2013 and rule 6(2) & 6(3A) of the Companies (cost records and audit) Rules, 2014]



Form of intimation of appointment of cost auditor by the company to Central Government

Form language English Hindi

Note: Refer the instruction kit for filing the form.

IN CASE OF REVISED CRA-2, ALL THE DETAILS MUST BE FILLED AFRESH.

1.(a) *Corporate identity number (CIN) or foreign company registration number (FCRN) of the company

(b) Global location number (GLN)

2.(a) Name of the company

(b) Address of the registered office or of the principal place of business in India of the company

(c) *e-mail ID of the company

(d) *Phone(with STD code) -

(e) *Nature of intimation of appointment of cost auditor(s)

(i) *Firm registration number(FRN) of the Cost auditor/Cost Auditor's firm/LLP	<input type="text"/>
(ii) *Name of the Cost Auditor/Cost Auditor's firm/LLP	<input type="text"/>
(iii) *Date of casual vacancy	<input type="text"/>
(iv) *Reason of casual vacancy	<input type="text"/>

3. *Product(s)/ Service(s) to which Cost Audit relates -

(a) Number of Industries/Sectors/Products/Services (CETA Heading Level, wherever applicable as per rules) covered under regulated sectors
Details of such industries/sectors/products/services

Industries/sectors/products/services	CETA heading (wherever Applicable)	No. of tariff items/ Products/ services
<input type="text"/>	<input type="text"/>	<input type="text"/>

(b) Number of Industries/Sectors/Products/Services (CETA Heading Level, wherever applicable as per rules) covered under non-regulated sectors

Details of such industries/sectors/products/services

Industries/sectors/products/services	CETA heading (wherever Applicable)	No. of tariff items/ Products/ services
<input type="text"/>	<input type="text"/>	<input type="text"/>

(4) *Details of all the cost auditor(s) appointed

Number of cost auditor(s)

I

(a) *Category of the auditor Individual Partnership firm Limited liability partnership (LLP)

(b) (i) *Membership number of the cost auditor or member representing the firm/LLP

(ii) *Name of the cost auditor or member representing the firm/LLP

(iii) *Firm Registration Number(FRN) of the Cost Auditor/Cost Auditor's firm/LLP

(iv) *Name of the Cost auditor's firm/LLP

(c) (i) Address * Line I
Line II

(ii) *City

(iii) *State

(iv) *Country

(v) * Pin code

(vi) *e-mail ID of the firm or member

(d) *Date of the board meeting in which cost auditor was appointed (DD/MM/YYYY)

(e) *Type of appointment
 Original Appointment due to casual vacancy Appointment for new products/services/location

(f) *Scope of audit of the cost auditor/firm/LLP

5.* Financial year to be covered by the cost auditor(s)

From (DD/MM/YYYY) To (DD/MM/YYYY)

(6)(a) *Is there any change in cost auditor(s) appointed from the previous financial year Yes No Not applicable



Attachments

(1). *Copy of Board resolution of the company

Attach

(2). Optional attachment, if any

Attach

List of attachments

Remove attachment

Declaration

I am authorized by the Board of Directors of the Company vide resolution number*
dated * to sign this form and declare that all the requirements of Companies Act, 2013 and the rules made thereunder in respect of the subject matter of this form and matters incidental thereto have been complied with. I also declare that all the information given herein above is true, correct and complete including the attachments to this form and nothing material has been suppressed.

*To be digitally signed by

*Designation

*Director identification number of the director; or PAN of the
Manager or CEO or CFO or authorized representative;
or Membership number of the Company Secretary

Note: Attention is drawn to provisions of Section 448 and 449 which provide for punishment for false statement / certificate and punishment for false evidence respectively.

Modify

Check Form

Prescrutiny

Submit

This Form has been taken on file maintained by the Central Government through electronic mode and on the basis of statement of correctness given by the company

Form CRA-3

[Pursuant to rule 6(4) of the Companies (Cost Records and Audit) Rules, 2014]

FORM OF THE COST AUDIT REPORT

I/We, having been appointed as Cost Auditor(s) under section 148(3) of the Companies Act, 2013(18 of 2013) of.....(mention name of the company) having its registered office at..... (mention registered office address of the company) (hereinafter referred to as the company), have audited the Cost Records maintained under section 148 of the said Act, in compliance with the cost auditing standards, in respect of the.....[mention name(s) of Product(s)/service(s)] for the period/year.....(mention the financial year) maintained by the company and report, in addition to my/our observations and suggestions in para 2.

- (i) I/We have/have not obtained all the information and explanations, which to the best of my/our knowledge and belief were necessary for the purpose of this audit.
 - (ii) In my/our opinion, proper cost records, as per rule 5 of the Companies (Cost Records and Audit) Rules, 2014 have/have not been maintained by the company in respect of product(s)/service(s) under reference.
 - (iii) In my/our opinion, proper returns adequate for the purpose of the cost audit have/have not been received from the branches not visited by me/us.
 - (iv) In my/our opinion and to the best of my/our information, the said books and records give/do not give the information required by the Companies Act, 2013, in the manner so required.
 - (v) In my/our opinion, the company has/does not have adequate system of internal audit of cost records which to my/our opinion is commensurate to its nature and size of its business.
 - (vi) In my/our opinion, information, statements in the annexure to this cost audit report gives/does not give a true and fair view of the cost of production of product(s)/rendering of service(s), cost of sales, margin and other information relating to product(s)/service(s) under reference.
 - (vii) Detailed unit-wise and product/service-wise cost statements and schedules thereto in respect of the product /service under reference of the company duly audited and certified by me/us are/are not kept in the company.
2. Observations and suggestions, if any, of the Cost Auditor, relevant to the cost audit.

Dated: this day of 20.....
at (mention name of place of signing this report)

SIGNATURE AND SEAL OF THE COST AUDITOR(S)
MEMBERSHIP NUMBER(S)



Notes:

- (1) Delete words not applicable.
- (2) If as a result of the examination of the books of account, the cost auditor desires to point out any material deficiency or give a qualified report, he/she shall indicate the same against the relevant para (i) to (vii) in the prescribed form of the Cost Audit Report giving details of discrepancies he/she has come across.
- (3) The report, suggestions, observations and conclusions given by the cost auditor under this paragraph shall be based on verified data, reference to which shall be made here and shall, wherever practicable, be included after the company has been afforded an opportunity to comment on them.

Annexure to the Cost Audit Report

PART - A

1. General Information

1	Corporate identity number or foreign company registration number	
2	Name of company	
3	Address of registered office or of principal place of business in India of company	
4	Address of corporate office of company	
5	Email address of company	
6	Date of beginning of reporting financial year	
7	Date of end of reporting financial year	
8	Date of beginning of previous financial year	
9	Date of end of previous financial year	
10	Level of rounding used in cost statements	
11	Reporting currency of entity	
12	Number of cost auditors for reporting period	
13	Date of board of directors meeting in which annexure to cost audit report was approved	
14	Whether cost auditors report has been qualified or has any reservations or contains adverse remarks	
15	Consolidated qualifications, reservations or adverse remarks of all cost auditors	
16	Consolidated observations or suggestions of all cost auditors	
17	Whether company has related party transactions for sale or purchase of goods or services	

2. General Details of Cost Auditor

1	Whether cost auditor is lead auditor	
2	Category of cost auditor	
3	Firm's registration number	
4	Name of cost auditor/cost auditor's firm	
5	PAN of cost auditor/cost auditor's firm	
6	Address of cost auditor or cost auditor's firm	
7	Email id of cost auditor or cost auditor's firm	
8	Membership number of member signing report	
9	Name of member signing report	
10	Name(s) of product(s) or service(s) with CETA heading	
11	SRN number of Form 23C / CRA-2	
12	Number of audit committee meeting attended by cost auditor during year	
13	Date of signing cost audit report and annexure by cost auditor	
14	Place of signing cost audit report and annexure by cost auditor	

3. Cost Accounting Policy

- (1) Briefly describe the cost accounting policy adopted by the Company and its adequacy or otherwise to determine correctly the cost of production/operation, cost of sales, sales realization and margin of the product(s)/service(s) under reference separately for each product(s)/service(s). The policy shall cover, inter alia, the following areas:
- (a) Identification of cost centres/cost objects and cost drivers.
 - (b) Accounting for material cost including packing materials, stores and spares, employee cost, utilities and other relevant cost components.
 - (c) Accounting, allocation and absorption of overheads.
 - (d) Accounting for depreciation/amortization.
 - (e) Accounting for by-products/joint-products or services, scraps, wastage etc.
 - (f) Basis for Inventory Valuation.
 - (g) Methodology for valuation of Inter-Unit/Inter Company and Related Party transactions.
 - (h) Treatment of abnormal and non-recurring costs including classification of other non-cost items.
 - (i) Other relevant cost accounting policy adopted by the Company.



- (2) Briefly specify the changes, if any, made in the cost accounting policy for the product(s)/service(s) under audit during the current financial year as compared to the previous financial year.
- (3) Observations of the Cost Auditor regarding adequacy or otherwise of the Budgetary Control System, if any, followed by the company.

4. **PRODUCT/SERVICE DETAILS (for the company as a whole)**

Name of Product(s) /Services)	UOM	CETA heading (wherever applicable)	Covered under Cost Audit Yes / No	Net Operational Revenue (net of taxes, duties etc.)	
				Current Year	Previous Year
1.					
2.					
3.					
4.					
.....					
Total net revenue from operations					
Other Incomes of company					
Total revenue as per financial accounts					
Extra ordinary income, if any					
Total revenue including extra ordinary income, if any					
Turnover as per Excise/Service Tax Records					

Note: Explain the difference, if any, between Turnover as per Annual Accounts and Turnover as per Excise/ Service Tax Records

PART-B
For Manufacturing Sector

1. QUANTITATIVE INFORMATION (for each product with CETA heading separately)			
Name of Product			
CETA heading			
Particulars	Unit of measure	Current Year	Previous Year
1. Available Capacity			
(a) Installed Capacity			
(b) Capacity enhanced during the year, if any			
(c) Capacity available through leasing arrangements, if any			
(d) Capacity available through loan license / third parties			
(e) Total available Capacity			
2. Actual Production			
(a) Self manufactured			
(b) Produced under leasing arrangements			
(c) Produced on loan license / by third parties on job work			
(d) Total Production			
3. Production as per Excise Records			
4. Capacity Utilization (in-house) %			
5. Finished Goods Purchased			
(a) Domestic Purchase of Finished Goods			
(b) Imports of Finished Goods			
(c) Total Finished Goods Purchased			
6. Stock and Other Adjustments			
(a) Change in Stock of Finished Goods			
(b) Self/Captive Consumption (incl. samples etc.)			
(c) Other Quantitative Adjustments, if any (wastage etc.)			
(d) Total Adjustments			
7. Total Available Quantity for Sale [2(d) +5(c) + 6(d)]			
8. Actual Sales			
(a) Domestic Sales of Product			
(b) Domestic Sales of Traded Product			
(c) Export Sale of Product			
(d) Export Sale of Traded Product			
(e) Total Quantity Sold			



2. ABRIDGED COST STATEMENT (for each product with CETA heading separately)								
	Name of Product							
	CETA heading							
	Unit of Measure							
		Production	Finished Goods Purchased	Finished Stock Adjustment	Captive Consumption	Other Adjustments	Quantity Sold	
	Current Year							
	Previous Year							
Sl No.	Particulars				Current Year		Previous Year	
					Amount (₹)	Rate per Unit (₹)	Amount (₹)	Rate per Unit (₹)
1	Materials Consumed (specify details as per Para 2A)							
2	Process Materials/chemicals							
3	Utilities (specify details as per Para 2B)							
4	Direct Employees Cost							
5	Direct Expenses							
6	Consumable Stores and Spares							
7	Repairs and Maintenance							
8	Quality Control Expenses							
9	Research and Development Expenses							
10	Technical know-how Fee / Royalty, if any							
11	Depreciation/Amortization							
12	Other Production Overheads							
13	Industry Specific Operating Expenses (specify details as per Para 2C)							
14	Total (1 to 13)							
15	Increase/Decrease in Work-in-Progress							
16	Less: Credits for Recoveries, if any							
17	Primary Packing Cost							
18	Cost of Production/Operations (14 + 15 to 17)							
19	Cost of Finished Goods Purchased							
20	Total Cost of Production and Purchases (18 +19)							
21	Increase/Decrease in Stock of Finished Goods							
22	Less: Self/Captive Consumption (incl. Samples, etc.)							
23	Other Adjustments (if any)							

24	Cost of Production/Operation of Product Sold (20 + 21 to 23)				
25	Administrative Overheads				
26	Secondary Packing Cost				
27	Selling and Distribution Overheads				
28	Cost of Sales before Interest (24 to 27)				
29	Interest and Financing Charges				
30	Cost of sales (28 + 29)				
31	Net sales Realization (net of Taxes and Duties)				
32	Margin [Profit/(Loss) as per Cost Accounts] (31 – 30)				

Notes:	
1.	Separate Cost Statement shall be prepared for each CETA Heading representing the product.
2.	In case the same product has different unit of measure, separate cost statement shall be provided for different unit of measures.
3.	The items of cost shown in the Proforma are Indicative and the same shall be reflected keeping in mind the materiality of the item of cost in the product. The Proforma may be suitably modified to meet the requirement of the industry/product.
4.	In case the company follows a pre-determined or standard costing system, the above cost statement should reflect figures at actuals after adjustment of variances if any.

2A. Details of Materials Consumed

Name of Product									
CETA heading									
Sl. No	Description of Material	Category	UOM	Current Year			Previous Year		
				Quantity	Rate per Unit (₹)	Amount	Quantity	Rate per Unit (₹)	Amount
1.									
2.									
3.									
4.									
5.									
6.									
7.									
8.									
9.									
10.									

Category: Indigenous/ Imported/ Self Manufactured



2B. Details of Utilities Consumed

Name of Product								
CETA heading								
Sl. No.	Description of Material	UOM	Current Year			Previous Year		
			Quantity	Rate per Unit (₹)	Amount	Quantity	Rate per Unit (₹)	Amount
1.								
2.								
3.								
4.								
5.								
6.								
7.								
8.								
9.								
10.								

2C. Details of Industry Specific Operating Expenses

Name of Product			
CETA heading			
Sl. No.	Description of Industry Specific Operating Expenses	Current Year	Previous Year
		Amount	Amount
1.			
2.			
3.			
4.			
5.			
6.			
7.			
8.			
9.			
10.			

PART-C
For Service Sector

1. QUANTITATIVE INFORMATION (for each service separately)			
Name of Service			
Service Code (if applicable)			
Particulars	Unit of Measurement	Current Year	Previous Year
1. Available Capacity			
(a) Installed Capacity			
(b) Capacity enhanced during the year, if any			
(c) Total available Capacity			
2. Actual Services Provided			
(a) Own Services			
(b) Services under contractual arrangements			
(c) Outsourced Services			
(d) Total Services			
3. Total Services provided as per Service Tax Records			
4. Capacity Utilization (in-house) %			
5. Actual Sales			
(a) Services rendered - Domestic			
(b) Services rendered - Export			
(c) Total Services Rendered			



2. ABRIDGED COST STATEMENT (for each service separately)					
Name of Service					
Service Code (if applicable)					
Unit of Measure					
		Services Provided	Captive Consumption	Other Adjustments	Services rendered
	Current Year				
	Previous Year				
Sl. No.	Particulars	Current Year		Previous Year	
		Amount (₹)	Rate per Unit (₹)	Amount (₹)	Rate per Unit (₹)
1	Materials Consumed (specify details as per Para 2A)				
2	Utilities (specify details as per Para 2B)				
3	Direct Employees Cost				
4	Direct Expenses				
5	Consumable Stores and Spares				
6	Repairs and Maintenance				
7	Quality Control Expenses				
8	Research and Development Expenses				
9	Technical know-how Fee / Royalty, if any				
10	Depreciation/Amortization				
11	Other Overheads				
12	Industry Specific Operating Expenses (specify details as per Para 2 C)				
13	Total (1 to 12)				
14	Less: Credits for Recoveries, if any				
15	Cost of Services provided (13 - 14)				
16	Cost of Outsourced/Contractual Services				
17	Total Services available (15 + 16)				
18	Less: Self/Captive Consumption				
19	Other Adjustments (if any)				
20	Cost of Services Sold (17 - 18 + 19)				
21	Administrative Overheads				
22	Selling and Distribution Overheads				
23	Cost of Sales before Interest (20+21+22)				
24	Interest & Financing Charges				
25	Cost of Sales (23 + 24)				
26	Net Sales Realization (Net of Taxes and Duties)				
27	Margin [Profit/(Loss) as per Cost Accounts] (26 - 25)				

NOTES:

1.	Separate Cost Statement shall be prepared for each service
2.	The items of cost shown in the proforma are indicative and the same shall be reflected keeping in mind the materiality of the Item of cost in the service.
3.	The Proforma may be suitably modified to meet the requirement of the Industry/service.
4.	In case the Company follows a pre-determined or standard costing system, the above cost statement shall reflect figures at actuals after adjustment of variances, if any.

2A. Details of Materials Consumed

Name of Service									
Service Code (if applicable)									
Sl. No.	Description of Material	Category	UOM	Current Year			Previous Year		
				Quantity	Rate per Unit (₹)	Amount	Quantity	Rate per Unit (₹)	Amount
1.									
2.									
3.									
4.									
5.									
6.									
7.									
8.									
9.									
10.									

Category: Indigenous/ Imported/ Self Manufactured

2B. Details of Utilities Consumed

Name of Service									
Service Code (if applicable)									
Sl. No.	Description of Material	UOM	Current Year			Previous Year			
			Quantity	Rate per Unit (₹)	Amount	Quantity	Rate per Unit (₹)	Amount	
1.									
2.									
3.									
4.									
5.									
6.									
7.									
8.									
9.									
10.									

2C. Details of Industry Specific Operating Expenses

Name of Service			
Service Code (if applicable)			
Sl. No.	Description of Industry Specific Operating Expenses	Current Year	Previous Year
		Amount	Amount
1.			
2.			
3.			
4.			
5.			
6.			
7.			
8.			
9.			
10.			



PART-D

1. PRODUCT AND SERVICE PROFITABILITY STATEMENT (for audited products/services)

Sl. no.	Particulars	Current Year			Previous Year		
		Sales ₹	Cost of Sales ₹	Margin ₹	Sales ₹	Cost of Sales ₹	Margin ₹
	Product 1						
	Product 2						
	Product 3						
etc.						
	Service 1						
	Service 2						
	Service 3						
 etc.						
	Total						

2. PROFIT RECONCILIATION (for the company as a whole)

Sl. no.	Particulars	Current Year ₹	Previous Year ₹
1	Profit or Loss as per Cost Accounting Records		
	(a) For the audited product(s)/service(s)		
	(b) For the un-audited product(s)/service(s)		
2	Add: Incomes not considered in cost accounts (specify details)		
	a)		
	b)		
	c)		
	d)		
	e)		
	f)		
	g)		
	h)		
	i)		
	j)		
	Total		

3	Less: Expenses not considered in cost accounts (specify details)		
	a)		
	b)		
	c)		
	d)		
	e)		
	f)		
	g)		
	h)		
	i)		
	j)		
4	Difference In Valuation of stock between financial accounts and cost accounts		
5	Adjustments for others (Specify)		
6	Profit or Loss as per Financial Accounts		
Note: Show abnormal wastages, expenses on strikes/lock-outs and any other items of expenses or incomes of abnormal nature etc. not considered in cost separately			

3.	VALUE ADDITION AND DISTRIBUTION OF EARNINGS (for the company as a whole)		
Sl. No.	Particulars	Current Year ₹	Previous Year ₹
	Value Addition:		
1	Gross Sales (excluding sales returns)		
2	Less: Excise duty, etc.		
3	Net Sales		
4	Add: Export Incentives		
5	Add/less: Adjustment In Finished Stocks		
6	Less: Cost of bought out inputs		
	(a) Cost of Materials Consumed		
	(b) Process Materials / Chemicals		
	(c) Consumption of Stores and Spares		
	(d) Utilities (e.g. power and fuel)		
	(e) Others, if any		
	Total Cost of bought out inputs		



7	Value Added		
8	Add: Income from any other sources		
9	Add: Extra Ordinary Income		
10	Earnings available for distribution		
	Distribution of Earnings to:		
1	Employees as salaries and wages, retirement benefits, etc.		
2	Shareholders as dividend		
3	Company as retained funds		
4	Government as taxes (specify)		
5	Extra Ordinary Expenses		
6	Others, if any (specify)		
7	Total distribution of earnings		

4. FINANCIAL POSITION AND RATIO ANALYSIS (for the company as a whole)

Sl. no.	Particulars	Units	Current Year	Previous Year
A.	Financial Position			
1	Share Capital			
2	Reserves and Surplus			
3	Long Term Borrowings			
4	(a) Gross Assets			
	(b) Net Assets			
5	(a) Current Assets			
	(b) Less: Current Liabilities & Provisions			
	(c) Net Current Assets			
6	Capital Employed			
7	Net Worth			
B.	Financial Performance			
1	Value Added			
2	Net Revenue from Operations of Company			
3	Profit before Tax (PBT)			

C.	Profitability Ratios			
1	PBT to Capital Employed (B3/A6)	%		
2	PBT to Net worth (B3/ A7)	%		
3	PBT to Value Added (B3/B4)	%		
4	PBT to net revenue from Operations (B3/B4)	%		
D.	Other Financial Ratios			
1	Debt- Equity Ratio	%		
2	Current Assets to Current Liabilities	%		
3	Value Added to Net Sales	%		
E.	Working Capital ratios			
1	Raw Materials Stock to Consumption	Months		
2	Stores and Spares to Consumption	Months		
3	Finished Goods Stock to Cost of Sales	Months		

Notes. 1. Capital Employed means average of net fixed assets (excluding effect of revaluation of Fixed assets) plus Non-current investments and net current assets existing at the beginning and close of the financial year.

2. Net Worth is as defined under clause (57) of section 2 of the Companies Act, 2013.

5. RELATED PARTY TRANSACTIONS (for the company as a whole)

Sl. no.	Name of the Related Party	Name of the Product / Service	Nature of Transaction (Sale, Purchase etc.)	Quantity in Kgs.	Transfer Price	Amount ₹	Normal Price	Basis adopted to determine the Normal Price
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								

Notes: 1. Details shall be furnished for each Related Party and Product /Service separately.

2. Details of Related Party transactions without Indicating the Normal Price and the basis thereof shall be considered as incomplete Information.



6. RECONCILIATION OF INDIRECT TAXES (for the Company as a whole)

	Particulars	Assessable Value ₹	Excise Duty ₹	Service Tax ₹	Cess and Others ₹	VAT/ CST ₹
	Total Clearances					
1	Domestic					
2	Export					
3	Stock Transfers (Net)					
4	Others etc.					
5	Total Excise Duty (1 to 4)					
6	Service Tax					
7	VAT, CST etc.					
8	Other State Taxes, if any					
9	Total Duties/Taxes Payable (5 to 8)					
	Duties/Taxes Paid					
10	Cenvat/VAT Credit Utilised- Inputs					
11	Cenvat/VAT Credit Utilised – Capital Goods					
12	Cenvat/VAT Credit Utilised – Input Services					
13	Cenvat/VAT Credit Utilised – Others					
14	Total (10 to 13)					
15	Paid through PLA/Cash					
16	Total Duties/Taxes paid (14 + 15)					
17	Duties/Taxes recovered					
18	Difference between Duties/Taxes Paid and Recovered					
19	Interest/Penalty/Fines Paid (interest paid on price revision)					

Note: Provide separate amounts in notes in respect of item 4 above.

SIGNATURE

NAME

COST AUDITOR

MEMBERSHIP NUMBER

SEAL

DATE

SIGNATURE

NAME

COMPANY

SECRETARY/DIRECTOR

MEMBERSHIP/DIN NUMBER

STAMP

DATE

SIGNATURE

NAME

DIRECTOR

DIN NUMBER

STAMP

DATE

Note.

- (1) Wherever, there is any significant variation in the current year's figure over the previous year's figure for any item shown under each para of the Annexure to the Cost Audit Report, reasons thereof shall be given by the Cost Auditor.
- (2) Wherever, duration of the current year or the previous year is not 12 (twelve) months, same shall be clearly indicated in the Report.

FORM NO. CRA-4

[Pursuant to section 148(6) of Companies Act, 2013 and rule 6(6) of the Companies (cost records and audit) Rules, 2014]



Form for filing Cost Audit Report with the Central Government

Form Language English Hindi

Refer the instruction kit for filing the form.

1.(a) *Corporate identity number (CIN) or foreign company registration number (FCRN) of the company

(b) Global location number (GLN) of company

2.(a) Name of the company

(b) Address of the registered office or of the principal place of business in India of the company

(c) *e-mail ID of the company

(d) *SRN of 23C/ CRA-2 filed for appointment of Cost Auditor(s)

3. (a) *Financial year for which cost auditor was initially appointed
From (DD/MM/YYYY) To (DD/MM/YYYY)

(b) *Whether any change in Financial Year Yes No

(d) *Date of Board of Directors meeting in which Annexure to the cost audit report was approved (DD/MM/YYYY)

4. (a) *State number of Industries/ Sectors/ Product(s)/ Service(s) (CETA heading level, wherever applicable as per Rules) for which the Cost Audit Report is being submitted

(i) Regulated

(ii) Non-Regulated

(b) Details of such Industries/ Sectors/ product(s)/ service(s) of the company

(i) Details of such industries/sectors/products/services under regulated sectors

Industries/sectors/products/services	CETA heading (wherever Applicable)	No. of tariff items/Products/ services
<input type="text"/>	<input type="text"/>	<input type="text"/>

(ii) Details of such industries/sectors/products/services under non-regulated sectors

Industries/sectors/products/services	CETA heading (wherever Applicable)	No. of tariff items/Products/ services
<input type="text"/>	<input type="text"/>	<input type="text"/>



5 (a) *State number of Industries/ Sectors/ Product(s)/ Service(s) (CETA heading level, wherever applicable as per Rules) not covered in the Cost Audit Report

(i) Regulated

(ii) Non-Regulated

(b) (i) Details of such Industries/ Sectors/ product(s)/ service(s) of the company under regulated sector

Industries/sectors/products/services	CETA heading (wherever Applicable)	No. of tariff items/Products/services
<input type="text"/>	<input type="text"/>	<input type="text"/>

(b) (ii) Details of such Industries/ Sectors/ product(s)/service(s) of the company under non-regulated sector

Industries/sectors/products/services	CETA heading (wherever Applicable)	No. of tariff items/Products/services
<input type="text"/>	<input type="text"/>	<input type="text"/>

(6) Details of the cost auditor(s) appointed

* (i) Number of cost auditor(s) appointed

(a) *Category of the auditor Individual Partnership firm Limited liability partnership (LLP)

(b)(i) *Membership number of the Cost Auditor/ member representing the Cost Auditor's Firm/LLP

(ii) * Name of the Cost Auditor/ member representing the Cost Auditor's Firm/LLP

(iii) * Firm registration number(FRN) of the Cost Auditor/Cost Auditor's firm/LLP

(iv) * Name of the Cost Auditor's firm/LLP

(c) (i) Address * Line I
Line II

(ii) *City

(iii) *State

(iv) Country

(v) * Pin code

(vi) *e-mail ID of the firm or member

(d) *Date of the board meeting in which cost auditor was appointed (DD/MM/YYYY)

(e) *Type of appointment Original Appointment due to casual vacancy
 Appointment for new products/services/locations

(f) *Scope of audit of the cost auditor/firm/LLP

(g) *Date of receipt of copy of cost audit report by the company (DD/MM/YYYY)

7. (a) *Whether the cost auditor's report has been qualified Yes No

If yes, please state

(b) *Whether cost auditor's report has any reservations Yes No

If yes, please state

(c) *Whether the cost auditor's report has any adverse remarks Yes No

If yes, please state

(d) *Whether the cost auditor's report contain any observations or suggestions

If yes, cost auditor's observations/ suggestions Yes No

Attachments

List of attachments

(1) *XBRL document in respect of the cost audit report and company's information and explanations on every qualification and reservation contained therein

Attach

(2). Optional attachment, if any.

Attach

Remove attachment

Declaration

*To the best of my knowledge and belief, the information given in this form and its attachments is correct and complete

I am authorized by the Board of Directors of the Company vide *resolution number *dated
(DD/MM/YYYY)

It is confirmed that the attached XBRL document(s) are the XBRL converted copy(s) of the duly signed cost audit report as required under Section 148(2) and company's information and explanations as required under Section 148(6) of the Companies Act, 2013 and the rules made thereunder. It is further confirmed that such document(s) have been prepared using XBRL taxonomy as notified by the Ministry of Corporate Affairs for this purpose.

***To be digitally signed by**

Director or Manager or CEO or CFO or Secretary of the company
(in case of Indian company) or authorised representative
(in case of Foreign company)

*Designation

*Director identification number of the Director; or PAN of the
Manager or CEO or CFO or authorized representative;
or membership number of the Company Secretary

Note: Attention is drawn to provisions of Section 448 and 449 which provide for punishment for false statement / certificate and punishment for false evidence respectively.

Modify

Check Form

Prescrutiny

Submit

This form has been taken on file by the Central Government through electronic mode and on the basis of statement of correctness given by the company



FAQ-1
19/03/2015

Frequently Asked Questions on
Maintenance of Cost Accounting Records and
Cost Audit under Companies Act, 2013

1.1 Which Rules govern maintenance of cost accounting records and cost audit as per Section 148 of the Companies Act, 2013?

The Central Government issued Companies (Cost Records and Audit) Rules, 2014 on June 30, 2014. Subsequently, it issued Companies (Cost Records and Audit) Amendment Rules, 2014 on December 31, 2014. The Amendment Rules has introduced certain changes to the original Rules issued on June 30, 2014. The Companies (Cost Records and Audit) Rules, 2014 read with the Amendment Rules 2014 are now applicable and governs the maintenance of cost accounting records and cost audit as per Section 148 of the Companies Act, 2013.

1.2 What is the applicability of the Companies (Cost Records and Audit) Rules, 2014 and what is the date on which it becomes effective and applicable?

- (a) The Rules have classified sectors/industries under Regulated and Non-Regulated sectors. The sectors/industries covered under Table A of the Rules are under the Regulated Sector and sectors/industries covered under Table B are under the Non-Regulated Sector.
- (b) Every company, including foreign companies defined in clause (42) of section 2 of the Act, engaged in the production of the goods or providing services, specified in Tables A and B, having an overall turnover from all its products and services of rupees thirty five crore or more during the immediately preceding financial year, shall be required to maintain cost accounting records.

However, foreign companies having only liaison office in India and engaged in production, import and supply or trading of medical devices listed in Sl. 33 of Table B are exempted. Further, companies which are 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) are also excluded from the purview of the Rules.

- (c) The Rules are effective from April 1, 2014 in respect of certain class of companies and for the others it is effective from April 1, 2015 as detailed below:

Rules Applicable from April 1, 2014 – Regulated Sectors

Sl.	Industry /Sector/ Product/Service	CETA Heading
1.	Telecommunication services made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997 (24 of 1997);	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), other than for captive generation (referred to in the Electricity Rules, 2005);

3.	Petroleum products 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;
4.	Drugs and pharmaceuticals	2901 to 2942; 3001 to 3006.
5.	Fertilizers;	3102 to 3105.
6.	Sugar and industrial alcohol;	1701; 1703; 2207

Rules Applicable from April 1, 2014 – Non-Regulated Sectors

Sl.	Industry /Sector/ Product/Service	CETA Heading
1.	Machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items; Explanation. – For the purposes 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 to 8402; 8801 to 8805; 8901 to 8908
2.	Turbo jets and turbo propellers;	8411
3.	Arms and ammunitions;	3601 to 3603; 9301 to 9306.
4.	Propellant powders; 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 by a Port in relation to a vessel or goods regulated by the Tariff Authority for Major Ports under section 111 of the Major Port Trusts Act, 1963 (38 of 1963);	Not applicable.
8.	Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008);	Not applicable.
9.	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;	Not applicable.
11.	Rubber and allied products being regulated by the Rubber Board constituted under the Rubber Act, 1947 (XXIV of 1947)	4001 to 4017
12.	Railway or tramway locomotives, rolling stock, railway or tramway fixtures and fittings, mechanical (including electro mechanical) traffic signalling equipment's of all kind;	8601 to 8608.
13.	Cement;	2523; 6811 to 6812
14.	Ores and Mineral Products;	2502 to 2522; 2524 to 2526; 2528 to 2530; 2601 to 2617
15.	Mineral fuels (other than Petroleum), mineral oils etc.;	2701 to 2708



Sl.	Industry /Sector/ Product/Service	CETA Heading
16.	Base metals;	7401 to 7403; 7405 to 7413; 7419; 7501 to 7508; 7601 to 7614; 7801 to 7802; 7804; 7806; 7901 to 7905; 7907; 8001; 8003; 8007; 8101 to 8113.
17.	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.
18.	Jute and Jute Products;	5303, 5310
19.	Edible Oil;	1507 to 1518
20.	Construction Industry as per para No.(5) (a) as specified in Schedule VI of the Companies Act, 2013 (18 of 2013)	Not applicable.
21.	Health services, namely functioning as or running hospitals, diagnostic centres, clinical centres or test laboratories;	Not applicable.
22.	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.
23.	Production, import and supply or trading of following medical devices, namely:	
	Cardiac Stents, Drug Eluting Stents, Catheters, Intra Ocular Lenses, Bone Cements, Heart Valves, Orthopaedic Implants, Internal Prosthetic Replacements, Scalp Vein Set, Deep Brain Stimulator, Ventricular peripheral Shud, Spinal Implants, Automatic Impalpable Cardiac Deflobillator, Pacemaker (temporary and permanent), patent ductus arteriosus, atrial septal defect and ventricular septal defect closure device, Cardiac Re-synchronize Therapy, Urethra Spinicture Devices, Sling male or female, Prostate occlusion device, Urethral Stents	9018 to 9022

Rules Applicable from April 1, 2015 – Non-Regulated Sectors

Sl.	Industry /Sector/ Product/Service	CETA Heading
1.	Coffee and tea;	0901 to 0902
2.	Milk powder;	0402
3.	Insecticides;	3808
4.	Plastics and Polymers;	3901 to 3914; 3916 to 3921; 3925
5.	Tyres and Tubes;	4011 to 4013
6.	Paper;	4801 to 4802
7.	Textiles;	5004 to 5007; 5106 to 5113; 5205 to 5212; 5303; 5310; 5401 to 5408; 5501 to 5516
8.	Glass;	7003 to 7008, 7011, 7016
9.	Other machinery;	8403 to 8487
10.	Electricals or electronic machinery;	8501 to 8507; 8511 to 8512; 8514 to 8515; 8517; 8525 to 8536; 8538 to 8547.

- 1.3 The Institute of Cost Accountants of India (ICAI-CMA) had, from time to time, issued FAQs subsequent to implementation of Companies (Cost Accounting Records) Rules, 2011 and Companies (Cost Audit report) Rules, 2011. Will the clarifications and FAQs remain valid subsequent to Companies (Cost Records and Audit) Rules, 2014 coming into effect?**

The FAQs and clarifications issued earlier are no longer valid. The same may be considered as withdrawn and not applicable for the Companies (Cost Records and Audit) Rules, 2014 unless specifically mentioned in these FAQs.

- 1.4 What constitutes the cost records under Rule 2(e)?**

As per Rule 2(e) the Companies (Cost Records and Audit) Rules, 2014, "cost records" means 'books of account relating to utilization 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'. There cannot be any exhaustive list of cost accounting records. Any transaction - statistical, quantitative or other details - that has a bearing on the cost of the product/activity is important and form part of the cost accounting records.

Cost records are to be kept on regular basis to make it possible to "calculate per unit cost of production/operations, cost of sales and margin for each of its products for every financial year on monthly/quarterly/half-yearly/annual basis". What is required is to maintain such records and details in a structured manner on a regular basis so that accumulation is possible on a periodical basis.

- 1.5 The Rules state that cost records are to be maintained in Form CRA-1. However, CRA-1 does not prescribe any format but only provides principles to be followed for different cost elements. What are the role and status of Cost Accounting Standards/GACAP and its applicability vis-à-vis CRA-1?**

The principles of maintenance of cost accounting records have been notified in the Rules in CRA-1. The principles are in sync with the cost accounting standards. The Rules are principle based and no formats have been prescribed for maintenance of cost accounting records like pre-2011 industry specific rules. No separate format based records maintenance has been prescribed even for the Regulated Industry and the prescription has left it open for industry to maintain cost accounting records according to its size and nature of business so long as it determines a true and fair view of the cost of production, cost of sales and margin of the products/services. The cost audit report is required to be in conformity with the "cost auditing standards" as referred to in Section 148 of the Companies Act, 2013.

It is also to be noted that the Council of the Institute of Cost Accountants of India has made it mandatory for cost accountants in practice to follow and conform to the Cost Accounting Standards issued by it and it is incumbent on the cost auditors to report any deviations from cost accounting standards.

- 1.6 What is the meaning of "Turnover" in relation to the Companies (Cost Records and Audit) Rules, 2014?**

Sub-section 91 of Section 2 of the Companies Act, 2013 defines "turnover" as "the aggregate value of the realization of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year. For the purposes of these Rules, "Turnover" means gross turnover made by the company from the sale or supply of all products or services during the financial year. It includes any turnover from job work or loan license operations but exclude duties and taxes. Export benefit received should be treated as a part of sales.

- 1.7 Whether overall annual Turnover/individual turnover definition will include other operational income like Job work income, scrap sale, trading turnover, export benefits, sales of services etc.?**

The Turnover shall include other operational income like Job work income, scrap sale, trading turnover, export benefits, sales of services etc.

- 1.8 Is maintenance of cost accounting records mandatory for a multi-product company where all the products are not covered under the Rules even if the Turnover of the individual product/s that are covered under the Rules is less than rupees thirty five crores?**

The Rules provide threshold limits for the company as a whole irrespective of whether all its products are as per the prescribed industry/sector provided under Table A or Table B. The Rules do not provide any minimum product specific threshold limits for maintenance of cost accounting records and consequently the company would be required to maintain cost accounting records for the products covered under Table-A or Table-B or both even if the turnover of such products is below rupees thirty five crores.



1.9 What is the difference between Cost Accounting policy and Cost Accounting system?

Cost Accounting Policy of a company state the policy adopted by the company for treatment of individual cost components in cost determination.

The Cost Accounting system of a company, on the other hand, provides a flow of the cost accounting data/information across the activity flow culminating in arriving at the cost of final product/service.

1.10 A company meets the threshold limits for both maintenance of cost records and cost audit in Year-0 (previous year) and consequently comes under the purview of the Rules in Year-1 (current year). If the turnover of company gets reduced to lower than the prescribed threshold limit in Year-1 (current year), whether Cost Records and Cost Audit will be applicable for Year-2 (next year).

Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 states that a company engaged in the production of the goods or providing of services as prescribed 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 account. Since the threshold limit for applicability of maintenance of cost accounting records is met in Year-0, the cost records are required to be maintained from Year-1. Once the maintenance of cost records becomes applicable, it would be maintained on a continuous basis in the subsequent years also. In the same line, cost audit will be applicable from Year-1 and for every year thereafter.

1.11 How to identify products covered under 4-digit CETA Code as mentioned in the Rules?

Central Excise Tariff Act Heading has been defined in Rule 2(aa) of Companies (Cost Records and Audit) Rules 2014. It states "*Central Excise Tariff Act Heading*" means the heading as referred to in the Additional Notes in the First Schedule to the Central Excise Tariff Act, 1985 [5 of 1986].

First Schedule to the Central Excise Tariff Act, 1985 states – "*heading*" in respect of goods, means a description in list of tariff provisions accompanied by a four-digit number and includes all sub-headings of tariff items the first four-digits of which correspond to that number.

1.12 The Rules prescribed in 2011 had introduced the concept of reporting under "Product Group". The present Rules are silent about Product Group. What is the requirement of preparation of cost statements of products/services so far as maintenance of cost accounting records is concerned and reporting thereof in the cost audit report?

The concept of "Product Group" has been dispensed with in the present Rules. The cost records referred to in sub-rule (1) of Rule 5 is required to 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**. Hence, it is imperative that the cost accounting records are required to be maintained and cost statements prepared for each and every product/service/activity that the company is engaged in.

So far as reporting is concerned, Abridged Cost Statement for every product identified with the CETA Code is required to be provided. For activities/services for which CETA Code is not applicable, the Abridged Cost Statement shall be for each service/activity.

1.13 Whether separate Form CRA-2 is required to be filed by a company having two or more different types of products covered under cost audit?

CRA-2 Form (intimation for appointment of cost auditor to Central Government) has replaced the earlier Form 23C (application seeking approval for appointment of cost auditor). A single Form CRA-2 is required to be filed providing details of the sectors/industries covered under cost audit and details of cost auditor. For Companies appointing multiple cost auditors, only one single Form CRA-2 is required to be filed. Provision has been made in the Form to accommodate details of multiple cost auditors.

1.14 The Tables listing the industry/sector/product/service in the Rules have described the same by way of description as well as CETA Heading, wherever applicable. For certain sectors, the coverage under the CETA Heading are apparently not in line with the description of the sector. How to determine the coverage in such cases?

The description and the CETA Heading have to be read harmoniously and construed to be supplementing each other. The CETA Heading has been provided in the amended Rules in addition to what was provided in the original Rules issued in June 2014. The CETA Codes are inclusive and all products covered under the codes are covered irrespective of the description.

For example, in case of Petroleum Industry, the description states "Petroleum products regulated by the Petroleum and Natural Gas Regulatory Board under the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006)" and the CETA Headings are 2709 to 2715. Hence, all products covered under CETA Headings 2709 to 2715 are included as well as activities like storage, transportation, distribution of Crude Oil or Gas etc. and any other activity that is defined under the Petroleum and Natural Gas Regulatory Board Act, 2006 and regulated by the PNGRB are covered.

Similarly, Rubber and allied products would include all rubber products as specified under CETA Codes 4001 to 4017 and will not be restricted only to such rubber products regulated by the Rubber Board.

Companies engaged in manufacturing Machinery and mechanical appliances falling under CETA Codes 8401 to 8402; 8801 to 8805; 8901 to 8908 are similarly covered irrespective of its ultimate customer/consumer, subject to the company meeting the threshold limits prescribed and it is not necessary that the products have to be exclusively used in defence, space and atomic energy sectors.

1.15 What is meant by Telecommunication Services and what is its coverage?

The Companies (Cost Records and Audit) Rules, 2014 has covered "Telecommunication services made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997 (24 of 1997)". The Telecom Regulatory Authority of India Act, 1997 defines "telecommunication service" as "service of any description (including electronic mail, voice mail, data services, audio text service, video text services, radio paging and cellular mobile telephone services) which is made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature, by wire, radio, visual or other electro-magnetic means but shall not include broadcasting services".

Subsequently, the Central Government has included broadcasting services within the ambit of telecommunication services by notifying "broadcasting services and cable services to be telecommunication service". [Notification No. 39 issued by Ministry of Communication and Information Technology dated 9 January 2004, S.O. No. 44(E) issued by TRAI, vide F. No. 13-1/2004].

In view of the above, Telecommunication Services made available to users and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997 would include all such services being regulated by TRAI including broadcasting services.

1.16 What is the coverage of "Roads and other infrastructure projects" under Item 10 of Table B of the Rules?

"Roads and other infrastructure projects" has been defined to be corresponding to para No.(1)(a) as specified in Schedule VI of the Companies Act, 2013. Sub-clause (a) to Para (1) of Schedule VI of the Companies Act, 2013 covers "Roads, national highways, state highways, major district roads, other district roads and village roads, including toll roads, bridges, highways, road transport providers and other road-related services". Hence, every activity including construction and maintenance of the above projects are covered under the Rules.

1.17 What is the coverage of Construction Industry under Item 21 of Table B of the Rules?

Construction Industry has been defined to be corresponding to para No. (5)(a) as specified in Schedule VI of the Companies Act, 2013. Para (5) of Schedule VI of the Companies Act, 2013 pertains to "Industrial, commercial and social development and maintenance" and covers "real estate development, including an industrial park or special economic zone" as per sub-clause (a). Hence, every construction activity in relation to the above are covered under the Rules.

1.18 What is the coverage of Aeronautical Services?

Clause 3(B)(8) of the Companies (Cost Records and Audit) Rules, 2014 covers under the ambit of the Rules "Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered by airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008)".

The Airports Economic Regulatory Authority of India Act, 2008 has defined "aeronautical services" as follows:

- (i) For navigation, surveillance, and supportive communication thereto for air traffic management;



- (ii) For the landing, housing or parking of an aircraft or any other ground facility offered in connection with aircraft operations at an airport;
- (iii) For ground safety services at an airport;
- (iv) For ground handling services relating to aircraft, passengers and cargo at an airport;
- (v) For the cargo facility at an airport;
- (vi) For supplying fuel to the aircraft at an airport;

The Rule has covered all the above services under the ambit of maintenance of cost accounting records and cost audit subject to threshold limits.

However, all airports and aircraft operations belonging to or subject to the control of the Armed Forces or paramilitary Forces of the Union are excluded from the scope of these Rules.

1.19 Whether maintenance of cost accounting records and cost audit thereof, subject to threshold limits prescribed, is applicable to products which are for 100% captive consumption?

The Companies (Cost Records and Audit) Rules, 2014 has specified different products and services for which maintenance of cost accounting records and cost audit thereof, subject to threshold limits prescribed, is mandatory.

In case a product is manufactured and 100% captively consumed for production of some other product which is also covered under these Rules and is subject to cost audit, then the cost of such captively consumed product would form part of the final product which is also under cost audit and as such a separate cost audit report for the captively consumed product will not be necessary.

However, if the product is partly for captive consumption and partly sold, or if the product is 100% captively consumed for production of some other product which is not covered under these Rules, then cost audit would be applicable for such captively consumed product(s).

1.20 What would be the treatment of cost consumption of electricity from a captive generating plant and applicability of cost audit to such captive generating plants?

Rule 3(A)(2) dealing with generation, transmission, distribution and supply of electricity has excluded captive generation as defined in the Electricity Rules, 2005. It may be noted that in case of a company whose product(s)/service(s) are covered under the Rules and it consumes electricity from the captive generating plant, determination of cost of generation, transmission, distribution and supply of electricity as per CRA-I would be mandatory since the cost of consumption of electricity has to be at cost. Hence, maintenance of cost records for generation, transmission, distribution and supply of electricity would be applicable. However, cost audit will not be applicable to such captive plants, provided the entire generation is consumed captively and no portion is sold outside.

1.21 A Company is engaged in both Regulated and Non-Regulated sectors and all its products are not covered under the Rules. How to determine applicability of cost audit for the products covered under the Regulated and Non-Regulated sectors since different threshold limits have been prescribed under Rule 4?

Rule 4 states that cost audit would be applicable for products under:

- (a) Table A if the overall turnover of the company is at least ₹ 50 crore and
- (b) Table B if the overall turnover of the company is ₹ 100 crore.

Hence, the coverage of cost audit for a company where all its products are covered under Table A or Table B or a combination of the two would be guided by these threshold limits.

In case of a multi-product company where all its products are not covered under Table A or Table B or a combination of both, then the following would apply:

- (a) If the overall turnover of the company is more than ₹ 50 crore but less than ₹100 crore, then only products covered under Table-A will be covered under cost audit provided the sum total of all the products of the company covered under Table A and Table B is more than ₹25 crore.
- (b) If the overall turnover of the company is more than ₹100 crore, then:

- (i) products under both Table A and Table B will be covered under cost audit provided the sum total of all the products of the company covered under Table A and Table B is more than ₹ 35 crore
- (ii) only products of Table A will be covered if the sum total of all the products of the company covered under Table A and Table B is more than ₹ 25 crore but less than ₹ 35 crore.

Explanation: Rule 4 has defined threshold limits for Table A and Table B separately but the aggregate turnover of the individual product or products or service or services has been defined to be all products for which cost records are required to be maintained under rule 3.

1.22 A company does job work for others. The raw materials are supplied to the company by the principal and the job worker gets conversion charges only. The Job Worker company pays the excise duty which is reimbursed by the principal. Will the job worker be covered under the Companies (Cost Records and Audit) Rules, 2014?

The Rules are applicable to a company. If the products of the Job Worker is listed under Table A or Table B of the Rules and the Job Worker company meets the threshold limits as prescribed, then the job worker company will be required to maintain cost accounting records. If the threshold criteria of the cost audit as prescribed are met, the company would be covered under cost audit also. Payment of excise duty by the Job Worker and in turn getting reimbursement for it is immaterial for application of the Rules.

1.23 Whether companies registered under Section 8 of the Companies Act, 2013 (corresponding to Section 25 of the Companies Act, 1956) and One Person Company (OPC) introduced in Companies Act, 2013 covered under the Rules?

The Companies (Cost Records and Audit) Rules, 2014 are applicable to every company registered under the Companies Act, 2013 which are engaged in production of goods or providing of services listed in Table-A or Table-B of Rule 3. Different threshold limits have been prescribed in the Rules for applicability of maintenance of cost accounting records and coverage under cost audit. Exemption has been granted only to companies which are 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) and foreign companies having only liaison offices engaged in Production, import and supply or trading of medical devices specified under Item 33 of Table-B of Rule 3. Any other legal entity registered as a company that meets the conditions stated in Rule 3 and Rule 4 are covered.

1.24 The manufacturing process of a company generates Metal Scrap during production of its main products which may or may not be covered under cost audit. Such scrap is sold in the market after the same is cleared under CETA Codes that are covered in the Rules. Will the company be covered under cost audit for generation of scrap?

Generation of scrap is not a production or processing or manufacturing but is incidental to manufacture of its main products. The Rules are applicable to production of goods or providing of services. CETA Codes have been inducted in the Rules for proper identification of Products that are manufactured. The act of payment of Excise Duty is immaterial in the context of application of the Rules. The generation of scrap and its consequent sale in the market cannot be construed to be covered under the Rules.

1.25 Whether Value Addition and Distribution of Earnings [Part D, Para 3] is to be computed based on Cost record data or audited financial data?

Value Addition statement is to be computed based on audited financial accounts.

1.26 Whether Financial Position and Ratio Analysis [Part D, Para 4] is to be computed based on Cost record data or audited financial data?

Financial Position and Ratio Analysis is to be computed based on audited financial accounts. This reporting Para has been aligned with the nomenclature of Schedule III of the Companies Act, 2013.

1.27 What is the procedure for appointment of cost auditor under the Companies Act, 2013?

The cost auditor is to be appointed by the Board of Directors on the recommendation of the Audit Committee, where the company is required to have an Audit Committee. The cost auditor proposed to be appointed is required to give a letter of consent to the Board of Directors. The company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within



a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in **form CRA-2**, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

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 inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

1.28 Who can be appointed as a cost auditor?

Only a Cost Accountant, as defined under section 2(28) of the Companies Act, 2013, can be appointed as a cost auditor.

Clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 defines "Cost Accountant". It means a Cost Accountant who holds a valid certificate of practice under sub-section (1) of section 6 of the Cost and Works Accountants Act, 1959 and is in whole-time practice. Cost Accountant includes a Firm of Cost Accountants and a LLP of cost accountants.

1.29 What are the eligibility criteria for appointment as a cost auditor?

Eligibility Criteria under Section 141 of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 and Section 148 of the Companies Act, 2013. The following persons are not eligible for appointment as a cost auditor:

- (a) A body corporate. However, a Limited Liability partnership registered under the Limited Liability Partnership Act, 2008 can be appointed. [Section 141(3)(a)].
- (b) An officer or employee of the company. [Section 141(3)(b)].
- (c) A person who is a partner, or who is in the employment, of an officer or employee of the company. [Section 141(3)(c)].
- (d) A person who, or his relative or partner is holding any security of or interest in the company or any of its subsidiary or of its holding or associate company or a subsidiary of such holding company. [Section 141(3)(d)(i)].
- (e) Relatives of any partner of the firm holding any security of or interest in the company of face value exceeding ₹ 1 lakh. [Section 141(3)(d)(i) and Rule 10(1) of Companies (Audit and Auditors) Rules, 2014].
- (f) A person who is indebted to the company or its subsidiary, or its holding or associate company or a subsidiary or such holding company, for an amount exceeding ₹ 5 lakhs. [Section 141(3)(d)(ii) and Rule 10(2) of Companies (Audit and Auditors) Rules, 2014].
- (g) A person who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for an amount exceeding ₹ 1 lakh. [Section 141(3)(d)(iii) and Rule 10(3) of Companies (Audit and Auditors) Rules, 2014].
- (h) A person or a firm who, whether directly or indirectly, has business relationship with the company or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company. [Section 141(3)(e) and Rule 10(4) of Companies (Audit and Auditors) Rules, 2014].

"Business Relationship" is defined in Rule 10(4) of Companies (Audit and Auditors) Rules, 2014 and the same shall be construed as any transaction entered into for a commercial purpose, except commercial transactions which are in the nature of professional services permitted to be rendered by a cost auditor or a cost audit firm under the Act and commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the cost auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

- (i) A person whose relative is a director or is in the employment of the company as a director or key managerial personnel of the company. [Section 141(3)(f)].
- (j) A person who is in the full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor if such person or persons is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies. [Section 141(3)(g)].

- (k) A person who has been convicted by a court for an offence involving fraud and a period of ten years has not elapsed from the date of such conviction. [Section 141(3)(h)].
- (l) Any person whose subsidiary or associate company or any other form of entity, is engaged as on date of appointment in consulting and providing specialised services to the company and its subsidiary companies: [Section 141(3)(i) and Section 144].
 - (a) accounting and book keeping services
 - (b) internal audit
 - (c) design and implementation of any financial information system
 - (d) actuarial services
 - (e) investment advisory services
 - (f) investment banking services
 - (g) rendering of outsourced financial services
 - (h) management services

1.30 The Companies Act, 2013 has introduced provision regarding rotation of auditors. Is the provision of rotation of auditors applicable to cost auditors also?

The provisions for maintenance of cost accounting records and cost audit are governed by Section 148 of the Companies Act, 2013. The provisions of Section 148 clearly states that no person appointed under Section 139 as an auditor of the company shall be appointed for conducting audit of cost records of the company. Section 148 also provides that qualifications, disqualifications, rights, duties and obligations applicable to auditors (financial) shall apply to a cost auditor appointed under this section. The eligibility, qualifications and disqualifications are provided in Section 141 of the Act and powers and duties are provided in Section 143. Section 143(14) specifically states that the provisions of Section 143 shall mutatis mutandis apply to a cost auditor appointed under Section 148. There are no other provisions governing the appointment of a cost auditor.

Section 139(3) of the Act, applicable to appointment of auditors (financial), and Rule 6 of Companies (Audit and Auditors) Rules, 2014 deals with the provision of rotation of auditors and these provisions are applicable only to appointment of auditors (financial). The Act does not provide for rotation in case of appointment of cost auditors and the same is not applicable to a cost auditor. It may, however, be noted that though there is no statutory provision for rotation of cost auditors, individual companies may do so as a part of their policy, as is the practice with Public Sector Undertakings.

1.31 What is the procedure to be followed for fixing the remuneration of a cost auditor?

Rule 14 of the Companies (Audit and Auditors) Rules, 2014 has laid down the procedure of appointment and fixing the remuneration of a cost auditor. It states as follows:

Remuneration of the Cost Auditor: For the purpose of sub-section (3) of section 148,—

- (a) in the case of companies which are required to constitute an audit committee—
 - (i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;
 - (ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;
- (b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.



1.32 What are the duties of the Companies in relation to provisions of Section 148 of the Companies Act, 2013 and the Rules framed thereunder?

Every company required to get cost audit conducted under Section 148(2) of the Companies Act, 2013 shall:-

- (a) Appoint a cost auditor within one hundred and eighty days of the commencement of every financial year;
- (b) Inform the cost auditor concerned of his or its appointment;
- (c) File a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in **form CRA-2**, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014;
- (d) 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 alongwith full information and explanation on every reservation or qualification contained therein, in **form CRA-4** along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

1.33 Is a cost auditor required to audit and certify monthly, quarterly, half-yearly and yearly cost statements?

As per Rule 5, every company under these rules including all units and branches thereof are required, in respect of each of its financial year, to maintain cost records in form CRA-1. The cost records are required to be maintained on regular basis in such manner so 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 auditor is appointed to conduct audit of the cost records and make report thereon for the financial year for which he is appointed. It is not incumbent upon the cost auditor to certify monthly, quarterly, half-yearly cost statements.

1.34 CRA-3 requires Details of Material Consumed, Details of Utilities Consumed and Details of Industry Specific Operating Expenses respectively [Part B and Part C, Para 2(a), 2(b) and 2(c)]. In case of companies where number of materials or utilities or industry specific operating expenses is more than 10 each, which items should be disclosed in the respective paras?

It is to be noted that the cost audit report is required to be filed in XBRL mode and there is no provision for extending the number of items under any of the heads to accommodate more than 10 items. Hence, in cases where number of such items is more than 10 under any of the heads of material or utility or industry specific operating expenses, the 9 main items in terms of value should be provided separately and the balance items should be clubbed together under "Others" and shown as the tenth item.

1.35 Whether figures are to be provided for Rupees per Unit or Amount in Rupees in the Product and Service Profitability Statement [CRA-3, Part D, Para 1]?

Amount in Rupees are required to be provided under this Para. The number of products or services will be equal to the number of products and services covered under cost audit and for which Abridged Cost Statement has been provided.

1.36 Is there any obligation on the part of cost auditor to report offence of fraud being or has been committed in the Company by its officers or employees?

Sub-rule (7) of Rule 6 of the Companies (Cost Records and Audit) Rules 2014 states that "*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*".

As per sub-section (12) of section 143 of the Companies Act 2013, extract of which is given above, it is obligatory on the part of cost auditor to report offence of fraud which is being or has been committed in the company by its officers or employees, to the Central Government as per the prescribed procedure under the Rules.

As per the proviso to above sub-section, it has been stated that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

FAQ-2

08/07/2015

Frequently Asked Questions on Maintenance of Cost Accounting Records and Cost Audit under Companies Act, 2013

2.1 What types of Educational Services are covered under the Companies (Cost Records and Audit) Rules 2014?

The Companies (Cost Records and Audit) Rules 2014 covers **“Education services, other than such similar services falling under philanthropy or as part of social spend which do not form part of any business”**.

Any company imparting training or education by means of any mode is covered under Education Services. However, auxiliary services provided by companies, as a separate independent entity, to educational institutions viz., (i) transportation of students, faculty and staff; (ii) catering service including any mid-day meals scheme; (iii) security or cleaning or house-keeping services in such educational institution; (iv) services relating to admission to such institution or conduct of examination are not included under Education Services.

In case the educational institution covered under the Rules is providing the above auxiliary services as a part of their total operations, then the institution will be required to maintain records for such auxiliary services also.

2.2 What types of Health Services are covered under the Companies (Cost Records and Audit) Rules 2014?

The Companies (Cost Records and Audit) Rules 2014 covers **“Health services, namely functioning as or running hospitals, diagnostic centres, clinical centres or test laboratories”**.

Any company engaged in providing Health services through functioning as or running hospitals, diagnostic centres, clinical centres, test laboratories, physiotherapy centres and post-operative/treatment centres are covered within the ambit of the Companies (Cost Records and Audit) Rules 2014. Further, companies running hospitals exclusively for its own employees are excluded from the ambit of these Rules, provided however, if such hospitals are providing health services to outsiders also in addition to its own employees on chargeable basis, then such hospitals are covered within the ambit of these Rules.

It is clarified that companies engaged in running of Beauty parlours / beauty treatment are not covered under these Rules.

2.3 A company is engaged in construction of residential housing, offices, industrial units, Roads, Bridges, Marine facilities etc. having sites in India and abroad. The company also has Joint venture projects in India and abroad. Whether Companies (Cost Records and Audit) Rules 2014 would be applicable to the company?

All companies engaged in construction business either as contractors or as subcontractors, who meet with the threshold limits laid down in the Companies (Cost Records and Audit) Rules, 2014 and undertake jobs with the use of own materials [whether self-manufactured/produced or procured from outside] shall be required to maintain cost records and get cost audit conducted as per the provisions of the Companies (Cost Records and Audit) Rules, 2014.

The provisions of the Companies (Cost Records and Audit) Rules, 2014 would also apply for construction activities undertaken under BOT/BOOT mode, or the projects undertaken as EPC contractor or the projects undertaken abroad by a company incorporated in India.

The Companies (Cost Records and Audit) Rules, 2014, do not make any distinction between the Contractor and Sub-Contractor and accordingly all such companies will be included within the ambit of the Rules.

2.4 A company is engaged in manufacturing products on its own as well as purchase the same products from other companies. The outsourced products are treated as trading activity in the financial accounts. Same products are also manufactured by supply of materials to converters. What would be treatment of such products for the purposes of maintenance of cost accounting records and cost audit?

Products manufactured by the company as well as conversion activity through third parties will be covered under the Companies (Cost Records and Audit) Rules 2014 and the company would be required to maintain



cost accounting records and get cost audit conducted subject to threshold limits. The finished products bought from outside parties (treated as Trading Activity in Financial Accounts) would be reflected as "Cost of Finished Goods Purchased" in Abridged Cost Statement.

2.5 The Companies (Cost Records & Audit) Rules, 2014 provides exemption from cost audit to a company which is covered under rule 3, and whose revenue from exports, in foreign exchange, exceeds seventy five per cent of its total revenue. How to determine the percentage to total revenue in the following cases:

- (i) *In a company who is manufacturing Pharmaceutical products, the revenue from export of pharmaceutical products earned in foreign exchange divided by total revenue including other income etc. is 58%.*
- (ii) *The revenue in foreign exchange earned from export of pharmaceutical products plus revenue in foreign exchange earned from rendering of research & development service divided by total revenue including other income etc. is 82%.*

Cost audit is applicable for specified products/services. Rule 4(3) states "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 per cent of its total revenue". The inclusion or coverage of a company under Rule 3 is in respect of products/services listed under Table-A and Table-B and consequently the computation of 75% is to be calculated for the specific products/services covered under Rule 3 and not in respect of all the products/services of the company.

The total revenue and turnover of R&D Activities, not being covered under Rule 3 cannot be taken into consideration for computation of 75%.

In this connection it is also clarified that "total revenue" of a company is to be considered as the total revenue as defined in Schedule III of the Companies Act, 2013. Total Revenue as defined in Schedule III is Total Operating Revenue plus Other Incomes.

2.6 A company has units in SEZ and in non-SEZ areas. The Companies (Cost Records and Audit) Rules 2014 has exempted companies operating in special economic zones from cost audit. What would be applicability of the Companies (Cost Records and Audit) Rules 2014 on such a company in respect of maintenance of cost accounting records and cost audit?

Rule 3 of the Companies (Cost Records and Audit) Rules 2014 is specific and it has mandated maintenance of cost accounting records on all products/activities listed under Table-A and Table-B subject to threshold limits. No exemption is available to any company from maintenance of cost accounting records once it meets the threshold limits. Hence, the above company would be required to maintain cost accounting records for all its units including the one located in the special economic zone.

In view of the provisions of Rule 4(3)(ii) of the Companies (Cost Records and Audit) Rules 2014 the unit located in the special economic zone would be outside the purview of cost audit and the company would not be required to include particulars of such unit in its cost audit report. The other units of the company located outside the special economic zone would be covered under cost audit subject to the prescribed threshold limits.

2.7 A cost auditor is required to certify under Para 1(vii) of the Cost Audit Report – "Detailed unit-wise and product/service-wise cost statements and schedules thereto in respect of the product/service under reference of the company duly audited and certified by me/us are/are not kept in the company". Whether product Cost Sheet prepared SKU wise/ type-wise/ size-wise/ specification-wise by the company is required to be certified by the cost auditor and kept in the company?

Rule 5(2) of the Companies (Cost Records and Audit) Rules 2014 requires that "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".

The Rules have identified products as per CETA heading as defined in Rule 2(aa) which states "Central Excise Tariff Act Heading means the heading as referred to in the Additional Notes in the First Schedule to the Central Excise Tariff Act, 1985[5 of 1986]".

First Schedule to the Central Excise Tariff Act, 1985 states – “heading” in respect of goods, means a description in list of tariff provisions accompanied by a four-digit number and includes all sub-headings of tariff items the first four-digits of which correspond to that number.

The above definitions make it clear that maintenance of cost accounting records should conform to the CETA Heading and detailed unit-wise and product/service-wise cost statements and schedules thereto are required to be certified by the cost auditor.

2.8 In the abridged cost statement, what are Industry specific operating expenses? When should this be used?

Industry Specific operating expenses are those which are peculiar to a particular industry such as Telecommunication Industry which shows expenses such as Network Operating cost, License fee, Radio Spectrum charges, Microwave charges etc. which are peculiar to this Industry and should be disclosed separately in the cost statement. The Industry Specific operating expenses will vary from industry to industry depending upon the nature of operations. The industry specific operating expenses shall have to be identified and reported upon in the abridged cost statement.

2.9 What is installed capacity and how is this different from total available capacity? How the installed capacity is to be calculated in a multi-product company using the same machine/ facilities? Should installed capacity be the capacity at the beginning of the year or at the end of the year under audit?

The Institute of Cost Accountants of India has defined “*Installed Capacity is the maximum productive capacity, according to the manufacturer's specifications or determined through an expert study*” [CAS-2 of Cost Accounting Standards]. The Installed Capacity to be disclosed in the Quantitative Details of CRA-3 is to be considered as at the beginning of the year. Capacity enhanced during the year should be considered as the increase in Installed Capacity during the year on pro-rata basis. Available capacity is the total installed capacity after adjustment of capacity enhanced during the year and if any capacity is available by means of leasing arrangement or taking on third-party capacity for increasing the total capacity.

If the same available capacity is utilised for production of multiple products, the following different basis may be adopted to determine the available capacity in respect of each of the products:

- (i) If the company has a system of allocating the total available capacity for production of multiple products, then such allocated available capacity is to be considered for the products being manufactured by utilising the same production facility.
- (ii) If the production allocation is not pre-determined and changes from period to period, then the capacity utilisation is to be determined on the basis of total production of all the products taken together and the total available capacity should be considered for all the products.

2.10 Whether each and every transactions with Related Parties is to be disclosed under Para D-5 of Annexure to the Cost Audit Report?

Details of related Party Transaction are required to be provided in respect of each Related Party and each Product/Service for the year as a whole and not transaction-wise.

2.11 Revised Form CRA-2 has been made available by the Ministry of Corporate Affairs conforming to the Companies (Cost Records and Audit) Rules, 2014 on 31st December, 2014. What are the required attachments to Form CRA-2?

The Form has provided an attachment button for attachment of certified copy of the Board Resolution appointing the cost auditor. The consent letter of the cost auditor should be attached as optional attachment.

2.12 Is CRA-3 applicable for companies whose financial year commenced prior to April 1, 2014? Which Rules are applicable to companies whose financial year commenced on January 1, 2014?

The Section 148 of the Companies Act, 2013 and Companies (Cost Records and Audit) Rules, 2014 are applicable from April 1, 2014. Companies that were covered under the erstwhile Companies (Cost Accounting Records) Rules, 2011 and met the threshold limits prescribed therein are required to get the cost audit of their companies audited for the financial year 01/01/2014 to 31/12/2014 under the 2011 Rules and submit their respective reports under Companies (Cost Audit Report) Rules, 2011.



Companies (Cost Records and Audit) Rules, 2014 is applicable to companies maintaining calendar financial year from 01/01/2015 onwards subject to the products/services being covered under Table-A or Table-B of Rule 3 and meeting the prescribed threshold limits.

2.13 The Companies (Cost Records and Audit) Rules, 2014 requires submission of a single cost audit report at company level. What is the procedure of certifying and submission of cost audit report of a company where more than one cost auditor is appointed?

In case of a company having more than one cost auditor, it would be necessary for the company to appoint/designate one cost auditor as the lead cost auditor for consolidation of the report.

The individual cost auditors appointed for specific units/products would be required to audit and provide Para numbers A-4, B-1, B-2, B-2A, B-2B, B-2C, C-1, C-2, C-2A, C-2B, C-2C (as applicable), D-1 in respect of the products/services coming under the purview of their respective audits. The individual auditors would also be required to submit to the Board of Directors the individual cost audit report as per Form of the Cost Audit Report given in CRA-3.

The lead auditor would be responsible for preparing the Para numbers A-3, D-2, D-3, D-4, D-5, D-6 and consolidate Para numbers A-4, B-1, B-2, B-2A, B-2B, B-2C, C-1, C-2, C-2A, C-2B, C-2C (as applicable), D-1 received from the individual cost auditors.

The consolidated report should contain the reports of all the individual cost auditors including the report of the Lead Cost Auditor. In case individual cost auditors have any observations or suggestions or qualifications, they would be required to mention the same under Para 2 of the cost audit report and the lead auditor would have to mention the specific observations and/or qualifications of all the individual cost auditors in the place provided for the same in the under Para A-1.

The consolidated report so prepared would be converted to XBRL and submitted to the Central Government by the Company in Form CRA-4.

2.14 The Companies (Cost Records and Audit) Rules, 2014 covers "Generation, transmission, distribution and supply of electricity" with no corresponding CETA Heading. Whether the Quantitative Information and Abridged Cost Statement in respect of Electricity are required to be reported under the Service Sector in the absence of a CETA Heading?

The reporting of electricity generation activity will be considered under "Manufacturing" and should be shown under CETA Heading 2716. Transmission and Distribution activities should be reported under the "Service Sector".

2.15 A Company is engaged in both Regulated and Non-Regulated sectors and all its products are not covered under the Rules. How to determine applicability of cost audit for the products covered under the Regulated and Non-Regulated sectors since different threshold limits have been prescribed under Rule 4?

The above issue was clarified in FAQ-1 vide FAQ 1.21. The issue is further clarified by means of the following example for ease of understanding.

	Turnover (₹ Crores) of					Applicability of	
	Table A Products	Table B Products	Table A + B Products	Other Products	Total Operating Revenue	Cost Records	Cost Audit
Case 1	5	10	15	19	34	No	No
Case 2	5	10	15	25	40	Yes	No
Case 3	10	15	25	26	51	Yes	Only Table A Product
Case 4	0	25	25	26	51	Yes	No

Case 5	20	14	34	75	109	Yes	Only Table A Product
Case 6	20	20	40	61	101	Yes	Both Tables A & B Products

2.16 What is the status of companies after the notification of Companies (Cost Records and Audit) Rules, 2014, who have not filed cost audit report and/or compliance report pertaining to any year prior to financial year commencing on or after April 1, 2014?

Companies that were covered under the Companies (Cost Accounting Records) Rules, 2011 or any of the 6 industry specific Cost Accounting Records Rules and were required to file Compliance Report and/or Cost Audit Report for and upto any financial year commencing prior to April 1, 2014 are required to comply with the erstwhile Rules and file the Compliance Report and/or Cost Audit Report in XBRL Mode for the defaulted years. For this purpose, the Costing Taxonomy 2012 will continue to be available and such reports would be required to be filed in Form A-XBRL and Form I-XBRL, as the case may be.

2.17 Many Companies have filed Form 23C as well as Form CRA-2 for 2014-15 in respect of different products and/or multiple cost auditors, if applicable. Which SRN Number has to be reported in the cost audit report while filing the same in XBRL Mode?

- (a) Companies who have filed multiple Form 23C in respect of multiple cost auditors will be required to provide the SRN Numbers against each Form 23C filed.
- (b) In case the company after filing individual Form 23C has also filed Form CRA-2, in such case the company will be required to provide the SRN Number of the latest CRA-2 only since the details of multiple cost auditors, if applicable for the company, would be covered under one Form CRA-2.

2.18 A company is engaged in manufacturing of multiple products. Some of the products are covered under the Companies (Cost Records and Audit) Rules, 2014 and some are not. Part-A, Para 4 of the Annexure to the Cost Audit Report (Product/Service Details for the company as a whole) requires Net Operational Revenue to be reported for each CETA Heading for both the current year and the previous year. Can the Net Operational Revenue of all the Products that are not covered under the Rules be reported in this Para as a single line item?

Part-A, Para 4 of the Annexure to the Cost Audit Report of Companies (Cost Records and Audit) Rules, 2014 require reporting of Net Operational Revenue of every CETA Heading separately comprised in the Total Operational Revenue as per Financial Accounts. Hence, the company would be required to report Net Revenue of every CETA Heading irrespective of whether the same is covered under maintenance of cost accounting records and cost audit or not. In case some of the Products are under the same CETA Heading but having different units of measurement (UOM), then Net Revenue is to be reported for separate UOMs. It may be noted that the number of quantitative details and abridged cost statements will have to be provided for each unique combination of CETA Heading and UOM of the Products which are covered under cost audit.

If the company is engaged in manufacturing of products as well as providing of services and/or trading, such services which are covered under the Companies (Cost Records and Audit) Rules, 2014 will be required to be reported separately according to the definition provided in the Rules classified under different types of services within the same class of service. It may be noted that the number of quantitative details and abridged cost statements will have to be provided for each classification of service covered under cost audit.

Other services that are not covered under the Rules and Revenue from Trading Activity may be reported under suitable heads denoting the service/activity.

The New Taxonomy has introduced a separate line item in this Para to report "Other Operating Incomes" which will form part of the Total Operating Revenue.

Study Note - 3

COST AUDITOR - PROFESSIONAL ETHICS AND RESPONSIBILITIES



This Study Note includes

- 3.1 Cost Auditors – Definition
- 3.2 Professional Ethics
- 3.3 Duty of a Cost Auditor to Report Fraud - Section 143 of the Companies Act 2013
- 3.4 Punishment for Fraud (Section 447 of the Companies Act 2013)
- 3.5 Punishment for False Statement (Section 448 of the Companies Act, 2013)

3.1 COST AUDITOR – DEFINITION

Companies (Cost Records and Audit) Rules, 2014 defines Cost Auditor as under :

“Cost auditor” means a Cost Accountant in practice, as defined in clause (b), who is appointed by the Board; This definition is given under Rule 2(c).

“Cost Accountant in practice” means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 (23 of 1959), who holds a valid certificate of practice under sub-section (1) of section 6 of that Act and who is deemed to be in practice under sub-section (2) of section 2 thereof, and includes a firm or limited liability partnership of cost accountants; [Rule 2(b)]

Each and every member of the profession in practice is required to follow certain professional ethics and code of conduct as prescribed by the Cost and Works Accountants Act, 1959 and Regulations there under.

Section 22 of the CWA Act, 1959 defines that, the expression “professional or other misconduct” shall be deemed to include any act or omission provided in any of the Schedules but nothing in this section shall be construed to limit or abridge in any way the power conferred or duty cast on the Director (Discipline) under sub-section (1) of section 21 of the CWA Act, 1959 to inquire into the conduct of any member of the Institute under any other circumstances.

This definition under section 22 of the Cost and Works Accountants Act, 1959 read with the two schedules to the Act clarifies or indicates that the schedules provide an illustrative list of acts and omissions constituting “professional or other misconduct”

These are in addition to duty of Cost Auditor to report fraud under Section 143 (12) of the Companies Act 2013.

3.2 PROFESSIONAL ETHICS

CODE OF ETHICS

As professionals in the field of Cost and Management Accounting, the members of our Institute are bound by a code of professional ethics. This code stipulates and binds them to the highest level of care, duty and responsibility to their employers and clients, the public and their fellow professionals.

The objectives of the accountancy profession are to work to the highest standards of professionalism, to attain the highest levels of performance and generally to meet the public interest requirement. These objectives require four basic needs to be met:

- (a) Credibility in information and information systems;
- (b) Professionalism identified by employers, clients and other interested parties;
- (c) Quality of service carried out to the highest standards of performance; and
- (d) Confidence that there is a framework of professional ethics to govern the provision of services.

In order to achieve the objectives of the accountancy profession, cost accountants have to observe fundamental principles, which are:

(a) Integrity

A cost accountant should be straightforward and honest in performing his services.

(b) Objectivity

A cost accountant should be fair and should not allow prejudice or bias or the influence of others to override objectivity.

(c) Competence

A cost accountant must refrain from performing any service which he is not competent to carry out unless proper advice and assistance is obtained to ensure that the service is performed to the satisfaction.

(d) Confidentiality

A cost accountant must not disclose information acquired during the course of his engagement and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.

(e) Professional Behaviour

A cost accountant should act in a manner consistent with the good reputation of the profession.

In addition to the fundamental principles above a cost accountant in practice, should be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity, objectivity and independence.

THE COST AND WORKS ACCOUNTANTS ACT, 1959

It is an Act for the regulation of the profession of Cost Accountants. The regulation is exercised through the Institute. For the management of the affairs and for discharging the functions assigned to it by the Cost and Works Accountants Act, there is a Council of the Institute. The Council has been empowered to institute any enquiry into cases where it is prima facie of the opinion that a member is guilty of professional or other misconduct.



SCHEDULES TO THE ACT

THE FIRST SCHEDULE

PART I

PROFESSIONAL MISCONDUCT IN RELATION TO COST ACCOUNTANTS IN PRACTICE

A cost accountant in practice shall be deemed to be guilty of professional misconduct, if he:-

- (1) allows any person to practise in his name as a cost accountant unless such person is also a cost accountant in practice and is in partnership with or employed by himself;
- (2) pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional work, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner.

Explanation: In this item, "partner" includes a person residing outside India with whom a cost accountant in practice has entered into partnership which is not in contravention of item (4) of this part;

- (3) accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute:

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share, commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (2) of this Part;

- (4) enters into partnership, in or outside India, with any person other than a cost accountant in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (iv) of sub-section (1) of section 4 or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships;
- (5) secures, either through the services of a person who is not an employee of such cost accountant or who is not his partner or by means which are not open to a cost accountant, any professional business:

Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of items (2), (3) and (4) of this Part;

- (6) solicits clients or professional work, either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means:

Provided that nothing herein contained shall be construed as preventing or prohibiting-

- (i) any cost accountant from applying or requesting for or inviting or securing professional work from another cost accountant in practice;
 - (ii) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;
- (7) advertises his professional attainments or services, or uses any designation or expressions other than cost accountant on professional documents, visiting cards, letter heads or sign boards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the [Institute of Cost Accountants of India] or of any other institution that has been recognised by the Central Government or may be recognised by the Council :

Provided that a member in practice may advertise through a write up, setting out the services provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council;

PART II

PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE IN SERVICE

A member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person—

- (1) pays or allows or agrees to pay, directly or indirectly, to any person any share in the emoluments of the employment undertaken by him;
- (2) accepts or agrees to accept any part of fees, profit or gains from a lawyer, a cost accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

PART III

PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

- (1) not being a fellow of the Institute acts as a fellow of the Institute;
- (2) does not supply the information called for, or does not comply with the requirements asked for by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;
- (3) while inviting professional work from another cost accountant or while responding to tenders or enquiries or while advertising through a write up, or anything as provided for in items (6) and (7) of Part I of this Schedule, gives information knowing it to be false.

PART IV

OTHER MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if—

- (1) he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;
- (2) in the opinion of the Council he brings disrepute to the profession or the institute as a result of his action whether or not related to his professional work.



THE SECOND SCHEDULE

[See sections 21(3), 21B(3) and 22]

PART I

PROFESSIONAL MISCONDUCT IN RELATION TO COST ACCOUNTANTS IN PRACTICE

A cost accountant in practice shall be deemed to be guilty of professional misconduct, if he:—

- (1) discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client, or otherwise than as required by any law for the time being in force;
- (2) certifies or submits in his name, or in the name of his firm, a report of an examination of cost accounting and related statements unless the examination of such statements has been made by him or by a partner or an employee in his firm or by another cost accountant in practice;
- (3) permits his name or the name of his firm to be used in connection with an estimate of cost or earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast;
- (4) expresses his opinion on cost or pricing statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest;
- (5) fails to disclose a material fact known to him in a cost or pricing statement, which is not disclosed in a cost or pricing statement but disclosure of which is necessary in making such statement where he is concerned with such statement in a professional capacity;
- (6) fails to report a material mis-statement known to him to appear in a cost or pricing statement with which he is concerned in a professional capacity;
- (7) does not exercise due diligence, or is grossly negligent in the conduct of his professional duties;
- (8) fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion;
- (9) fails to invite attention to any material departure from the generally accepted procedure of costing and pricing applicable to the circumstances;
- (10) fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

PART II

PROFESSIONAL MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he-

- (1) contravenes any of the provisions of this Act or the regulations made there-under or any guidelines issued by the Council;
- (2) being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment, except as and when required by any law for the time being in force or except as permitted by the employer;
- (3) includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false;
- (4) defalcates or embezzles moneys received in his professional capacity.

PART III

OTHER MISCONDUCT IN RELATION TO MEMBERS OF THE INSTITUTE GENERALLY

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.]

CONSTITUTION OF DISCIPLINARY DIRECTORATE, BOARD OF DISCIPLINE AND DISCIPLINARY COMMITTEE

Section 21 (1) of the Cost and Works Accountants Act, 1959 provides for constitution of the Disciplinary Directorate, Board of Discipline and Disciplinary Committee. For purposes of provisions of this Act Disciplinary Directorate, Board of Discipline and Disciplinary Committee, and Director (Discipline) shall have same powers as are vested in a civil court under the Code of Civil Procedure .

PENALTIES UNDER THE ACT

Section 24 of the CWA Act, 1959: Penalty for falsely claiming to be a member, etc.

Any person who,-

- (i) not being a member of the Institute-
 - (a) represents that he is a member of the Institute; or
 - (b) uses the designation cost accountant; or
- (ii) being a member of the Institute, but not having a certificate of practice, represents that he is in practice or practices as a cost accountant, shall be punishable on first conviction with fine which may extend to one thousand rupees, and on any subsequent conviction with imprisonment which may extend to six months, or with fine which may extend to five thousand rupees, or with both.

Section 25 of the CWA Act, 1959: Penalty for using name of the Council, awarding degrees of cost accountancy, etc.

- (1) Save as otherwise provided in this Act, no person shall,-
 - (i) use a name or a common seal which is identical with the name or the common seal of the Institute or so nearly resembles it as to deceive or as is likely to deceive the public;
 - (ii) award any degree, diploma or certificate or bestow any designation which indicates or purports to indicate the position or attainment of any qualification or competence in cost accountancy similar to that of a member of the Institute; or
 - (iii) seek to regulate in any manner whatsoever the profession of [cost accountants.]
- (2) Any person contravening the provisions of sub-section (1) shall, without prejudice to any other proceedings which may be taken against him, be punishable on first conviction with fine which may extend to one thousand rupees, and on any subsequent conviction with imprisonment which may extend to six months, or with fine which may extend to five thousand rupees, or with both.
- (3) Omitted w.e.f. 8/8/2006
- (4) If the Central Government is satisfied that any diploma or certificate or any designation granted or conferred by any person other than the Institute, which purports to be a qualification in cost accountancy but which, in the opinion of the Central Government, falls short of the standard of qualifications prescribed for cost accountants and does not in fact indicate or purport to indicate the position or attainment of any qualification or competence in cost accountancy similar to that of a member of the Institute, it may, by notification in the Official Gazette and subject to such conditions as it may think fit to impose, declare that this section shall not apply to such diploma or certificate or designation.



Section 26 of the CWA Act, 1959: Companies not to engage in cost accountancy.

- (1) No company, whether incorporated in India or elsewhere, shall practice as cost accountants.
- (2) Any contravention of the provisions of sub-section (1) shall be punishable on first conviction with fine which may extend to one thousand rupees, and on any subsequent conviction to five thousand rupees.

[Explanation: For the removal of doubts, it is hereby declared that the "company" shall include any limited liability partnership which has company as its partner for the purposes of this section.]

Section 27 of the CWA Act, 1959: Unqualified persons not to sign documents.

- (1) No person other than a member of the Institute shall sign any document on behalf of a cost accountant in practice or a firm of such cost accountants in his or its professional capacity.
- [(2) Any person who contravenes the provisions of sub-section (1) shall, without prejudice to any other proceedings which may be taken against him, be punishable on first conviction with a fine not less than five thousand rupees but which may extend to one lakh rupees, and in the event of a second or subsequent conviction with imprisonment for a term which may extend to one year or with a fine not less than ten thousand rupees but which may extend to two lakh rupees or with both.]

Section 28 of the CWA Act, 1959: Offences by companies.

- ❖ If the person committing an offence under this Act is a company, the company as well as every person in charge of, and responsible to, the company for the conduct of its business at the time of the commission of the offence shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly : Provided that nothing contained in this sub-section shall render any such person liable to any punishment if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence. (2) Notwithstanding anything contained in sub-section (1), where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or that the commission of the offence is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.
- ❖ Explanation: For the purposes of this section,- (a) "company", with respect to an offence under section 24, section 25 or section 27, means any body corporate and includes a firm or other association of individuals; and with respect to an offence under section 26 means a body corporate; and (b) "director", in relation to a firm, means a partner in the firm.

Section 29 of the CWA Act, 1959: Sanction to prosecute.

- ❖ No person shall be prosecuted under this Act except on a complaint made by or under the order of the Council or of the Central Government.

3.3 DUTY OF A COST AUDITOR TO REPORT FRAUD - SECTION 143 OF THE COMPANIES ACT 2013

- ❖ **According to Section 143(12) of the Companies Act 2013**, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within such time and in such manner as may be prescribed.
- ❖ Sub-Section 13 specifies that no duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter referred to in sub-section (12) if it is done in good faith.

- ❖ Sub-Section 14 makes it clear that the provisions of this section shall *mutatis mutandis* apply to the cost accountant in practice conducting cost audit under section 148.
- ❖ According to Sub-Section 15 if any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.
- ❖ Matter to be reported immediately but not later than 2 days of his knowledge specifying:
 - (a) Nature of Fraud with description;
 - (b) Approximate amount involved; and
 - (c) Parties involved.
- ❖ Following disclosures to be made in Board's Report:
 - (a) Nature of Fraud with description;
 - (b) Approximate Amount involved;
 - (c) Parties involved, if remedial action not taken; and
 - (d) Remedial actions taken.

3.4 PUNISHMENT FOR FRAUD (SECTION 447 OF THE COMPANIES ACT, 2013)

Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud:

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

Explanation.—For the purposes of this section—

- (i) "fraud" in relation to affairs of a company or any body corporate, includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

3.5 PUNISHMENT FOR FALSE STATEMENT (SECTION 448 OF THE COMPANIES ACT, 2013)

Save as otherwise provided in this Act, if in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement,—

- (a) which is false in any material particulars, knowing it to be false; or
- (b) which omits any material fact, knowing it to be material,

he shall be liable under section 447.

Study Note - 4

COST ACCOUNTING STANDARDS AND GACAP



This Study Note includes

- 4.1 Cost Accounting Standards
- 4.2 Guidance Notes on Cost Accounting Standards
- 4.3 Generally Accepted Cost Accounting Principles (GACAP)

Cost Accounting Standards are set of standards that are designed to achieve 'uniformity and consistency in cost accounting practices.'

The Institute of Cost Accountants of India, recognizing the need for structured approach to the measurement of cost in manufacture or service sector and to provide guidance to the user organizations, government bodies, regulators, research agencies and academic institutions to achieve uniformity and consistency in classification, measurement and assignment of cost to product and services, has constituted Cost Accounting Standards Board (CASB) with the objective of formulating the Cost Accounting Standards.

Keeping in view latest legal and contemporary developments, the Cost Accounting Standards Board develops Cost Accounting Standards.

The Cost Accounting Standards:

- provide a structured approach to measurement of costs in manufacturing process or service industry;
- integrate, harmonize, and standardize cost accounting principles and practices;
- provide guidance to users to achieve uniformity and consistency in classification, measurement, assignment, and allocation of costs to products and services;
- arrive at the basis of computing the cost of product, activity, or service where required by legal or regulatory bodies;
- enable practicing members to make use of Cost Accounting Standards in the attestation of General Purpose Cost statements; and
- assist in clear and uniform understanding of all the related issues by various user organizations, government bodies, regulators, research agencies, and academic institutions.

4.1 COST ACCOUNTING STANDARDS

The structure of Cost Accounting Standard consists of Introduction, Objectives of issuing standards, Scope of standard, Definitions and explanations of the terms used in the standard, Principles of Measurement, Assignment of Cost, Presentation and Disclosure.

So far, the Institute has released 24 Cost Accounting Standards [CASs].

A gist of these standards is tabulated below.

LIST OF COST ACCOUNTING STANDARDS (CAS) AND GUIDANCE NOTES ISSUED AS ON DATE			
CAS No.	Title	Effective Date (For the period commencing from)	Guidance Note
CAS 1 (Revised 2015)	Classification of Cost	1st April 2015	
CAS 2 (Revised 2015)	Capacity Determination	1st April 2016	Guidance Note on Capacity Determination CAS-2 (Revised 2015)
CAS 3 (Revised 2015)	Production and Operation Overheads	1st April 2016	
CAS 4	Cost of Production for Captive Consumption	1st April 2010	Revised Guidance Note on Cost of Production for Captive Consumption (CAS-4)
CAS 5	Average (Equalized) Cost of Transportation	1st April 2010	
CAS 6	Material Cost	1st April 2010	Guidance Note on Material Cost (CAS-6)
CAS 7	Employee Cost	1st April 2010	Guidance Note on Employee Cost (CAS-7)
CAS 8	Cost of Utilities	1st April 2010	Guidance Note on Cost of Utilities (CAS-8)
CAS 9	Packing Material Cost	1st April 2010	Guidance Note on Packing Material Cost (CAS-9)
CAS 10	Direct Expenses	1st April 2010	Guidance Note on Direct Expenses (CAS-10)
CAS 11	Administrative Overheads	1st April 2010	Guidance Note on Administrative Overheads (CAS-11)
CAS 12	Repairs and Maintenance Cost	1st April 2010	Guidance Note on Repairs and Maintenance Cost (CAS-12)
CAS 13	Cost of Service Cost Centre	1st April 2011	
CAS 14	Pollution Control Cost	1st April 2012	
CAS 15	Selling and Distribution Overheads	1st April 2013	



CAS 16	Depreciation and Amortisation	1st April 2014	
CAS 17	Interest and Financing Charges	1st April 2014	
CAS 18	Research and Development Costs	1st April 2014	
CAS 19	Joint Costs	1st April 2014	
CAS 20	Royalty and Technical Know-How Fee	1st April 2014	
CAS 21	Quality Control	1st April 2014	
CAS 22	Manufacturing Cost	1st April 2015	
CAS 23	Overburden Removal Cost	1st April 2017	
CAS 24	Treatment of Revenue in Cost Statements	1st April 2017	
			Guidance Note on Treatment of Costs Relating to Corporate Social Responsibility (CSR) Activities

1. **Introduction** of the standard tells as to what the subject matter that the standard deals with.
2. **Objective** of the standard explains the way of bring uniformity and consistency in the principles of Cost for disclosure and presentation in the cost statements of a product or service.
3. **Scope** of the standard specifies that it shall be applied to cost statements, which require classification, presentation and disclosure of cost including those requiring attestation.
4. **Definitions** are the terms that are being used in the standard with their meanings specified.
5. **Principles of Measurement** specify the way of determining the value of various elements of cost. E.g. commonly, any element of cost shall not include, abnormal costs, imputed cost etc.
6. **Assignment** refers to the assignment of any element of cost to the cost of production, commonly, like "Cause and Effect", "Benefits received" etc. Costs shall be directly traced to a Cost object to the extent it is economically feasible any if not, shall be assigned to the cost object on appropriate basis
7. **Presentation** refers to the principle of whether an element of cost shall be presented as separate cost head or as a part of a class or group of costs, mostly indirect. This depends on the classification of the specific element of cost as direct or indirect.
8. **Disclosures** specify the details of the disclosures to be made in the cost statements in respect of the specific elements of cost.
9. **Effective date** for all the standards, commonly, will be given at the end, which is the specific date of its commencement / enforcement.

Students are advised to thoroughly go through all the standards, along with the guidance notes, on specific standards, issued by the Institute, for a comprehensive understanding. In view of the mandatory application of these standards, in conducting cost audits, it is essential to ensure that in the preparation and presentation of the cost statements, annexures to the cost audit report are in full compliance of these standards.

CAS –1
(REVISED 2015)
COST ACCOUNTING STANDARD ON
“CLASSIFICATION OF COST

The following is the COST ACCOUNTING STANDARD - 1 (CAS - 1) (Revised 2015) issued by the Council of the Institute of Cost Accountants of India for determination of “**CLASSIFICATION OF COST**”. In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material which has been set in normal type.

1. **Introduction**

This standard deals with the principles of Classification of Cost for determining the cost of product or service.

2. **Objective**

The objective of this standard is to bring uniformity and consistency in the principles of Classification of Cost for disclosure and presentation in the cost statements of a product or service.

3. **Scope**

This standard shall be applied to cost statements, which require classification, presentation and disclosure of cost including those requiring attestation.

4. **Definitions**

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal Cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/or due to some abnormal situation of the production or operation.***

4.2 ***Administrative Overheads: Cost of all activities relating to general management and administration of an entity.***

Administrative overheads shall exclude production overheads, marketing overheads and interest and finance charges. Administrative overheads do not include administration cost relating to production, factory, works or manufacturing.

4.3 ***Classification of cost: Classification of cost is the arrangement of items of costs in logical groups having regard to their nature (subjective classification) and purpose (objective classification).***

4.4 ***Conversion cost: Conversion cost is the production cost excluding the cost of direct materials.***

4.5 ***Cost: Cost is a measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services.***

Manufacturing of goods or rendering services involves consumption of resources. The type of cost often referred to in the costing system depends on the purpose for which cost is incurred. For example, material cost is the price of materials consumed for manufacturing a product or for rendering a service.

4.6 ***Cost Centre: Any unit of an entity selected with a view to accumulating all cost under that unit. The unit can be division, department, section, group of plant and machinery, group of employees or combination of several units.***

Cost Centre is the logical unit for accumulation of cost. Cost Centre may be of two types –personal and impersonal cost centres. Personal cost centre consists of a person or a group of persons. Cost centres which are not personal cost centres are impersonal cost centres. Cost centres may also be classified into broad types i.e. Operating Cost Centres and Support- Service Cost Centres. Operating Cost Centres are those which are in the chain of operations like machine shop, welding shop, assembly shop, operation theatre, callcentre and so on. Support-service Cost centres are for rendering services to operating cost centre like power house, maintenance, stores, help desk, transport for call centre staff and so on.



4.7 **Cost Object:** *An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.*

4.8 **Cost of Production:** *Cost of production of a product or a service consists of cost of materials consumed, direct employee costs, direct expenses, production overheads, quality control costs, packing costs, research and development costs and administrative overheads relating to production.*

Cost of production of a service means cost of the service rendered. To arrive at cost of production of goods, including those dispatched for captive consumption, adjustment for stock of work-in-process, finished goods, recoveries for sales of scrap, wastage and the like, shall be made.

4.9 **Cost of Transportation:** *Cost of Transportation comprises of the cost of freight, cartage, transit insurance and cost of operating fleet and other incidental charges whether incurred internally or paid to an outside agency for transportation of goods but does not include detention and demurrage charges.*

Cost of transportation is classified as inward transportation cost and outward transportation cost.

4.10 **Cost Unit:** *Cost Unit is a form of measurement of volume of production of a product or a service. Cost Unit is generally adopted on the basis of convenience and practice in the industry concerned.*

Examples:

- Power - MW
- Cement - MT
- Automobile - Number
- Transportation - Tonne- Kilometre

4.11 **Development Cost:** *Development cost is the cost for application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.*

4.12 **Direct Employee Cost:** *Employee costs, which can be attributed to a cost object in an economically feasible way.*

4.13 **Direct Expenses:** *Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost.*

Examples:

- Royalties charged on production
- Job charges
- Hire charges for use of specific equipment for a specific job
- Software services specifically required for a job

4.14 **Direct Materials:** *Materials, the costs of which can be attributed to a cost object in an economically feasible way.*

4.15 **Distribution Overheads:** *Distribution overheads, also known as distribution costs, are the costs incurred in handling a product or service from the time it is ready for despatch or delivery until it reaches the ultimate consumer including the units receiving the product or service in an inter-unit transfer.*

The cost of any non manufacturing operations such as packing, repacking and labelling at an intermediate storage location will be part of distribution cost.

Examples:

- Secondary packing
- Outward transportation cost
- Warehousing cost

- Cost of delivering the products to customers
- Clearing and forwarding charges
- Cost of mending *or replacing packing materials at distribution point.*

4.16 Employee Cost: Benefits paid or payable for the services rendered by employees (including temporary, part time and contract employees) of an entity.

Explanation:

- 1 Contract employees include employees engaged by the employer on contract basis; either directly or through a contractor but does not include employees of any contractor engaged in the entity for a contractual job.
- 2 Compensation paid to employees for the past period on account of any dispute / court orders in the current period shall form part of employee cost, but not a part of production cost.
- 3 Short provisions of prior period employee cost in current period shall form part of the employee cost in the current period, but not a part of production cost.

Employee cost includes payment made in cash or kind.

4.17 Fixed Costs: Fixed costs are costs which do not vary with the change in the volume of activity. Fixed indirect costs are termed fixed overheads.

4.18 Indirect Employee Cost: Employee cost, which cannot be directly attributed to a particular cost object.

4.19 Indirect Expenses: Expenses, which cannot be directly attributed to a particular cost object.

4.20 Indirect Materials: Materials, the costs of which cannot be directly attributed to a particular cost object.

4.21 Marketing overheads: Marketing Overheads comprise of selling overheads and distribution overheads.

4.22 Material Cost: The cost of material used for the purpose of production of a product or rendering a service.

4.23 Normal capacity: Normal Capacity is the production achieved or achievable on an average over a number of periods or seasons under normal circumstances taking into account the loss of capacity resulting from planned maintenance.

The above definition is also applicable for normal capacity in relation to a service being rendered.

4.24 Overheads: Overheads comprise costs of indirect materials, indirect employees and indirect expenses.

4.25 Packing Material Cost: The cost of material of any nature used for the purpose of packing of a product.

Packing material can be classified into primary packing material and secondary packing material. Primary packing material is essential to hold and preserve the product for its use by the customer and secondary packing material enables to store, transport, inform the customer, promote and otherwise make the product marketable.

4.26 Prime cost: Prime cost is the aggregate of direct material cost, direct Employee cost and direct expenses.

4.27 Production Overheads: Indirect costs involved in the production of a product or in rendering service.

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning. Production overheads include administration costs relating to production, factory, works or manufacturing.

4.28 Research Cost: Research cost is the cost of original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

4.29 Selling Overheads: Selling overheads are the expenses related to sale of products or services and include all indirect expenses incurred in selling the products or services.

Selling overheads are also known as selling costs.



4.30 Semi Variable Costs: Semi Variable Costs are the costs that contain both fixed and variable elements. They partly change with the change in the level of activity.

4.31 Support-Service Cost Centre: The cost centre which primarily provides auxiliary services across the entity.

The cost centre which provides services to production, operation or other service cost centre but not directly engaged in manufacturing process or operation or in rendering a service is a support-service cost centre. A support-service cost centre renders services to other cost centre's/other units and in some cases to outside parties.

Examples:

- Engineering
- Workshop
- Quality control
- Quality assurance
- Designing
- Laboratory
- Help desk
- Transport for call centre staff

4.32 Standard Cost: A predetermined cost of a product or service based on technical specifications and efficient operating conditions.

Standard costs are used as scale of reference to compare the actual cost with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them.

4.33 Variable Costs: Variable costs are the cost which tends to directly vary with the volume of activity.

Variable indirect costs are termed as variable overheads.

5. Principles of Classification of Costs

5.1 Costs shall be classified by the process of grouping the components of cost under a common designation on the basis of similarities of nature, attributes or relations. Items grouped together under common heads shall be further classified according to their fundamental differences.

It is the process of identification of each item and the systematic placement of like items together according to their common features. The same costs may appear in several different classifications depending on the purpose of classification.

Cost is classified normally in terms of managerial objective. Its presentation normally requires sub-classification. Such sub-classification may be according to nature of the cost elements, functional lines, areas of responsibility, or some other useful break-up. The appropriate sub-classification depends upon the uses to be made of the cost report.

Cost may be classified with reference to the nature of expense, its traceability to a cost object (direct/indirect), its relation to functions /activities, its behaviour (fixed, semi-variable or variable) and its relationship to production process.

5.2 Scheme of classification shall be such that every item of cost is classified.

6. Classification of Costs

6.1 By Nature of expenses

6.1.1 *Items of costs differ on the basis of their nature. Costs shall be gathered together in their natural groupings such as material, employee and expenses. The elements of cost can be classified in the following three categories :*

- i) Material**
- ii) Employee**
- iii) Expenses**

6.1.2 *Material Costs are cost of materials used for the purpose of production of a product or rendering of a service, net of trade discounts, rebates, taxes and duties refundable that can be quantified with reasonable accuracy.*

6.1.3 *Employee Costs are consideration, including benefits paid or payable to employees, permanent or temporary, for the purpose of production of a product or rendering of a service.*

It is the aggregate of all kinds of consideration paid and payable for the services rendered by employees of an entity (including temporary, part time and contract employees). Consideration includes wages, salaries, and other payments, including benefits, as applicable.

6.1.4 *Expenses are costs other than material cost and employee cost for the purpose of production of a product or rendering of a service.*

Examples:

- Cost of utilities
- Payment for bought out services
- Job processing charges

6.2 By nature of traceability to a cost object

6.2.1 **Classification shall be on the basis of method of assigning cost to a cost object. If a cost can be assigned to a cost object in an economically feasible way, it shall be termed as direct to that cost object. A cost that cannot be assigned directly shall be indirect cost.**

6.2.2 *Direct Material Costs are the cost of materials which can be assigned to a cost object in an economically feasible way.*

Raw materials consumed for production of a product or rendering of a service which are identifiable to the product or service form the direct material cost. Direct material cost includes cost of procurement, freight inward, taxes & duties and insurance directly attributable to the acquisition of the material. Trade discounts, rebates, duty drawbacks, refunds of duties/taxes and other similar items are deducted in determining the costs of direct material.



6.2.3 Direct Employee Cost are employee costs, which can be assigned to a cost object in an economically feasible way.

Example :

The cost of wages of those workers who are readily identified or linked with a cost centre or cost object, including the fringe benefits like provident fund contribution, gratuity, ESI, overtime, incentives, bonus, ex-gratia, leave encashment and wages for holidays and idle time.

6.2.4 Direct Expenses are expenses, which can be assigned to a cost object.

Examples:

- Expenses for special moulds required in a particular cost centre
- Hiring charges for tools and equipments for a cost centre
- Royalties in connection to a product
- Job processing charges

6.2.5 Indirect Material Costs are cost of materials, which cannot be directly assigned to a particular cost object in an economically feasible way.

Examples:

- Consumable spares and parts
- Lubricants
- Cost of computer stationary for administrative function

6.2.6 Indirect Employee costs are employee costs, which cannot be directly assigned to a particular cost object in an economically feasible way.

Examples:

- Salaries of security staff
- Operating manager's salary

6.2.7 Indirect Expenses are expenses, which cannot be directly assigned to a particular cost object in an economically feasible way.

Examples:

- Insurance
- Rates and Taxes

6.3 By function

6.3.1 Costs shall be classified according to major functions viz:

- **Production/ Project;**
- **Administration;**
- **Selling;**

- **Distribution;**
- **Research;**
- **Development;**

6.4 *By nature of behaviour*

6.4.1 *Costs shall be classified based on behaviour in response to the changes in the activity levels such as, fixed cost, variable cost and semi-variable cost.*

6.5 *By nature of production or operation process*

6.5.1 *Costs shall also be classified on the basis of nature of production or operation process.*

6.5.2 *Batch Cost shall be the aggregate cost related to a cost unit which consist of a group of similar articles or services which maintain its identity throughout one or more stages of production or operation.*

6.5.3 *Process cost shall be the cost of production or operation process where goods are produced or services rendered from a sequence of continuous or repetitive operations or processes during a period.*

6.5.4 *Operation Cost shall be the cost a specific operation involved in production of goods or rendering of services.*

6.5.5 *Contract cost shall be the cost of a contract agreed upon between the contractee and the contractor.*

6.5.6 *Joint costs are the costs of common resources used for producing two or more products or rendering two or more services simultaneously.*

7. *Presentation*

7.1 *The cost items in the cost statement shall be presented on 'basis of relevant classification'.*

7.2 *The classification of cost items shall be followed consistently from period to period.*

8. *Disclosure*

8.1 *Any change in classification of cost shall be made only if it is required by law or for compliance with a Cost Accounting Standard or such change would result in a more appropriate preparation or presentation of cost statements of an entity.*

8.2 *Any change in classification of cost which has a material effect on the cost of the product shall be disclosed in the cost statements. Where the effect of such change is not ascertainable wholly or partly, the fact shall be indicated in the cost statement.*



CAS – 2

(REVISED 2015)

COST ACCOUNTING STANDARD ON CAPACITY DETERMINATION

The following is the Cost Accounting Standard - 2 (Revised 2015) on "Capacity Determination" issued by the Council of the Institute of Cost Accountants of India. This standard replaces CAS-2 (Revised 2012) on Capacity Determination. In this Standard, the standard portions have been set in **bold italic** type. These are to be read in the context of the background material, which has been set in normal type.

1. Introduction

- 1.1 This standard deals with the principles and methods of determining the capacity of a facility for producing goods or providing services by an entity.
- 1.2 ***This standard deals with the principles and methods of classification and determination of capacity of an entity for ascertainment of the cost of product or service, and the presentation and disclosure in cost statements.***

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determination of capacity with reasonable accuracy.

3. Scope

This standard shall be applied to the cost statements, including those requiring attestation, which require determination of capacity for assignment of overheads.

4. Definitions

The following terms are being used in this standard with the meaning specified.

- 4.1 ***Abnormal Idle Capacity: Abnormal idle capacity is the difference between normal capacity and actual capacity utilization where the actual capacity is lower than the normal capacity.***
- 4.2 ***Actual capacity utilization: Actual capacity utilization is measured in terms of volume of production achieved or service provided in a specified period.***

Volume may be measured in terms of units produced or services provided or equivalent machine or man hours, as applicable.

Actual capacity utilization is usually expressed as a percentage of installed capacity.
- 4.3 ***Cost Object: An activity, contract, cost Centre, customer, product, process, project, service or any other object for which costs are ascertained.***
- 4.4 ***Installed capacity: Installed capacity is the maximum capacity of producing goods or providing services, determined either based on technical specification of the facility or through a technical evaluation.***
- 4.5 ***Normal Capacity: Normal capacity is the volume of production or services achieved or achievable on an average over a period under normal circumstances taking into account the reduction in capacity resulting from planned maintenance.***
- 4.6 ***Normal Idle Capacity: Normal idle capacity is the difference between installed and normal capacity.***

5. Determination of Capacity:

- 5.1 Capacity shall be determined in terms of units of production or services or equivalent machine or man hours.
- 5.2 ***Installed capacity***

Installed capacity is usually determined based on:

 - i) Technical specifications of facility.***

- ii) Technical evaluation.**
- iii) Capacities of individual or interrelated production or operation Centres.**
- iv) Operational constraints or capacity of critical machines or equipment.**
- v) Number of shifts or machine hours or man hours.**

In case technical specifications of facility are not available, the estimates by technical experts on capacity under ideal conditions shall be considered for determination of installed capacity.

In case the installed capacity is assessed as per direction of the Government or regulator it shall be in accordance with the said directives.

5.3 Reassessment of Installed Capacity:

Installed capacity shall be reassessed in case of any change due to addition, deletion, modification or for any other reason from the date of such change.

In case the installed capacity is reassessed as per direction of the Government or regulator it shall be in accordance with the said directives.

5.4 Normal Capacity:

Normal capacity is determined after suitable adjustments to the Installed Capacity.

The adjustments may be of the following nature:

- (i) Time lost due to scheduled preventive or planned maintenance
- (ii) Number of shifts or machine hours or man hours.
- (iii) Holidays, normal shut down days, normal idle time,
- (iv) Normal time lost in batch change over

6. Presentation

6.1 Cost Statements shall present Installed capacity, normal capacity and actual production of goods or services provided, in absolute terms.

6.2 Actual Capacity utilization shall be presented as a percentage of installed capacity.

7. Disclosure:

7.1 The cost statements shall disclose the following:

- a. Basis for arriving at different types of capacity.**
- b. Changes in the installed capacity or normal capacity with reason thereof.**
- c. Capacity enhanced through outsourcing.**
- d. Capacity outsourced to others.**
- e. Details of actual production of goods or services provided.**
 - a) Self-Manufactured goods or services provided through in-house facility**
 - b) Goods Produced or services provided through outsourcing**
- f. Reasons for low capacity utilization.**
- g. Abnormal cost due to under-utilization of capacity.**

7.2 Disclosures shall be made only where material, significant and quantifiable.

7.3 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.

8. Effective date

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2016 for being applied for the preparation and certification of General Purpose Cost Accounting Statement.



CAS-3 (REVISED 2015)

COST ACCOUNTING STANDARD ON "PRODUCTION AND OPERATION OVERHEADS"

The following is the Cost Accounting Standard on Production and Operation Overheads (CAS-3) (Revised 2015) issued by the Council of the Institute of Cost Accountants of India. This standard replaces CAS-3 (Revised 2011) on Overheads. In this Standard, the standard portions have been set in **bold italic** type. This standard shall be read in the context of the background material, which has been set in normal type.

1. Introduction

1.1 This standard deals with the principles and methods of determining the Production or Operation Overheads.

1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of Production or Operation Overheads, for determination of the cost of goods produced or services provided and for the presentation and disclosure in cost statements.***

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Production or Operation Overheads with reasonable accuracy.

3. Scope

This standard shall be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of Production or Operation Overheads including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected or due to some abnormal situation of the production or operation.***

4.2 ***Absorption of Production or Operation Overheads: Assigning of Production or Operation Overheads to cost objects by means of appropriate absorption rate.***

Overhead Absorption Rate = Production or Operation Overheads of the Activity divided by the volume of activity.

For example the rate obtained by dividing the overheads of a Machine Shop by machine hours.

4.3 ***Administrative Overheads: Cost of all activities relating to general management and administration of an entity.***

Administrative overheads shall exclude production overheads, marketing overheads and finance cost. Production overheads includes administration cost relating to production, factory, works or manufacturing.

4.4 ***Cost Centre: Any unit of an entity selected with a view to accumulating all costs under that unit. The unit can be division, department, section, group of plant and machinery, group of employees or combination of several units.***

A cost centre includes a process, function, activity, location, item of equipment, group of persons or any other unit in relation to which costs are accumulated.

4.5 ***Cost Object: An activity, contract, cost centre, customer, product, process, project, service or any other object for which costs are ascertained.***

- 4.6 **Fixed costs:** Fixed costs are costs which do not vary with the change in the volume of activity. Fixed indirect costs are termed fixed overheads.
- 4.7 **Imputed Cost:** Notional cost, not involving cash outlay, computed for any purpose.
- 4.8 **Indirect Employee Cost:** Employee cost, which cannot be directly attributed to a particular cost object.
- 4.9 **Indirect Expenses:** Expenses, which cannot be directly attributed to a particular cost object.
- 4.10 **Indirect Material Cost:** Material cost that cannot be directly attributed to a particular cost object.
- 4.11 **Normal capacity:** Normal capacity is the volume of production or services achieved or achievable on an average over a period under normal circumstances taking into account the reduction in capacity resulting from planned maintenance (In line with paragraph 4.5 of CAS – 2 (Revised 2015)).
- 4.12 **Production or Operation Overheads:** Indirect costs involved in the production of a product or in providing service.

The terms Production Overheads, Operation Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

Production or Operation Overheads include administration cost relating to production, factory, works or manufacturing and providing of services.

In addition Production or Operation Overheads shall also be classified on the basis of behaviour such as variable Production or Operation Overheads, semi-variable Production or Operation Overheads and fixed Production or Operation Overheads.

- Variable Production or Operation Overheads comprise of expenses which vary in proportion to the change of volume of production or activity or services provided.
- Semi Variable Costs are the costs that contain both fixed and variable elements. They partly change with the change in the level of activity.
- Fixed overhead are indirect costs which do not vary with the change in the volume of production or activity or service provided.

- 4.13 **Standard Cost:** A predetermined cost of a product or service based on technical specifications and efficient operating conditions.

Standard costs are used as scale of reference to compare the actual cost with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

- 4.14 **Variable costs:** Variable costs are the cost which tends to directly vary with the volume of activity.

5. Principles of Measurement:

- 5.1 **Production or Operation Overheads representing procurement of resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), taxes and duties refundable or to be credited.**
- 5.2 **Production or Operation Overheads other than those referred to in paragraph 5.1 shall be determined on the basis of cost incurred in connection therewith.**

In case of machinery spare fabricated internally or a repair job carried out internally, it will include cost incurred on material, employees and expenses.

- 5.3 **Any abnormal cost where it is material and quantifiable shall not form part of the Production or Operation Overheads.**



- 5.4 *Production or Operation Overheads shall not include imputed cost.*
- 5.5 *Production or Operation Overhead variances attributable to normal reasons shall be treated as part of Production or Operation Overheads. Overhead variances attributable to abnormal reasons shall be excluded from Production or Operation Overheads.*
- 5.6 *Any subsidy, Grant, Incentive or amount of similar nature received or receivable with respect to Production or Operation Overheads shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.*
- 5.7 *Fines, penalties, damages and similar levies paid or payable to statutory authorities or other third parties shall not form part of the Production or Operation Overheads.*
- 5.8 *Credits or recoveries relating to the Production or Operation Overheads, material and quantifiable, shall be deducted from the total Production or Operation overheads to arrive at the net Production or Operation Overheads. Where the recovery exceeds the total Production or Operation Overheads, the balance recovery shall be treated as other income.*
- 5.9 *Any change in the cost accounting principles applied for the measurement of the Production or Operation Overheads shall be made only if, it is required by law or for compliance with the requirements of a cost accounting standard, or a change would result in a more appropriate preparation or presentation of cost statements of an entity.*
6. **Assignment**
- 6.1 *While assigning Production or Operation Overheads, traceability to a cost object in an economically feasible manner shall be the guiding principle. The cost which can be traced directly to a cost object shall be directly assigned.*
- 6.2 *Assignment of Production or Operation Overheads to the cost objects shall be based on either of the following two principles;*
- i) **Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost.**
- ii) **Benefits received – Production Overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.**
- In case of facilities created on a standby or ready to serve basis, the cost shall be assigned on the basis of expected benefits instead of actual.
- 6.3 *Absorption of Production or Operation Overheads shall be as follows:*
- 6.3.1 *The variable Production or Operation Overheads shall be absorbed to products or services based on actual production.*
- 6.3.2 *The fixed Production or Operation Overheads shall be absorbed based on the normal capacity.*
7. **Presentation**
- 7.1 *Production or Operation Overheads shall be presented as separate cost head.*
- 7.2 *If material, element wise and behaviour wise details of the Production or Operation Overheads shall be presented.*
- 7.3 *Any under-absorption or over-absorption of Production or Operation Overheads shall be presented in the reconciliation statement.*

8. Disclosures

8.1 *The cost statements shall disclose the following:*

1. *The basis of assignment of Production or Operation Overheads to the cost objects.*
2. *Production or Operation Overheads incurred in foreign exchange.*
3. *Production or Operation Overheads relating to resources received from or supplied to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).*

Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement

4. *Any Subsidy, Grant, Incentive or any amount of similar nature received or receivable reduced from Production or Operation Overheads.*
5. *Credits or recoveries relating to the Production or Operation Overheads.*
6. *Any abnormal cost not forming part of the Production or Operation Overheads.*
7. *Any unabsorbed Production or Operation Overheads.*

8.2 *Disclosures shall be made only where material, significant and quantifiable.*

8.3 *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*

8.4 *Any change in the cost accounting principles and methods applied for the measurement and assignment of the Production or Operation Overheads during the period covered by the cost statement which has a material effect on the Production or Operation Overheads shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*

9. Effective date

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2016 for being applied for the preparation and certification of General Purpose Cost Accounting Statement.



CAS-4

COST ACCOUNTING STANDARD ON COST OF PRODUCTION FOR CAPTIVE CONSUMPTION

The following is the text of the COST ACCOUNTING STANDARD 4 (CAS-4) issued by the Council of the Institute of Cost and Works Accountants of India on "Cost of Production for Captive Consumption". The standard deals with determination of cost of production for captive consumption. In this Standard, the standard portions have been set in **bold italic** type. These should be read in the context of the background material which has been set in normal type.

1. Introduction

The Cost Accounting principle for determination of cost of production is well established. Similarly, rules for levy of excise duty on goods used for captive consumption are also well defined. Captive Consumption means the consumption of goods manufactured by one division and consumed by another division(s) of the same organization or related undertaking for manufacturing another product(s). Liability of excise duty arises as soon as the goods covered under excise duty are manufactured but excise duty is collected at the time of removal or clearance from the place of manufacture even if such removal does not amount to sale. Assessable value of goods used for captive consumption is based on cost of production. According to the Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000, the assessable value of goods used for captive consumption is 115% (**110% w.e.f. 05-08-2003**) of cost of production of such goods, and as may be prescribed by the Government from time to time.

2. Objective

- 2.1 The purpose of this standard is to bring uniformity in the principles and methods used for determining the cost of production of excisable goods used for captive consumption.
- 2.2 The cost statement prepared based on standard will be used for determination of assessable value of excisable goods used for captive consumption.
- 2.3 The standard and its disclosure requirement will provide better transparency in the valuation of excisable goods used for captive consumption.

3. Scope

- 3.1 The standard is to be followed for determining the cost of production to arrive at an assessable value of excisable goods used for captive consumption.
- 3.2 Cost of production will include various cost components. They are already defined in Cost Accounting Standard-1 (Classification of Cost – CAS-1). Thus, this standard has to be read in conjunction with CAS-1.

4. Definitions

- 4.1 ***Cost of Production: Cost of production shall consist of Material Consumed, Direct Wages and Salaries, Direct Expenses, Works Overheads, Quality Control cost, Research and Development Cost, Packing cost, Administrative Overheads relating to production.***

To arrive at cost of production of goods dispatched for captive consumption, adjustment for Stock of work-in-Process, finished goods, recoveries for sales of scrap, wastage etc shall be made.

- 4.2 ***Captive Consumption: Captive Consumption means the consumption of goods manufactured by one division or unit and consumed by another division or unit of the same organization or related undertaking for manufacturing another product(s).***
- 4.3 ***Normal Capacity is the production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance. (CAS-2)***

5. Determination of Cost of Production for Captive Consumption

To determine the cost of production for captive consumption, calculations of different cost components and adjustments are explained below:

5.1 Material Consumed

Material Consumed shall include materials directly identified for production of goods such as:

- (a) indigenous materials**
- (b) imported materials**
- (c) bought out items**
- (d) self manufactured items**
- (e) process materials and other items**

Cost of material consumed shall consist of cost of material, duties and taxes, freight inwards, insurance and other expenditure directly attributable to procurement. Trade discount, rebates and other similar items will be deducted for determining the cost of materials. Cenvat credit, credit for countervailing customs duty, Sales Tax set off, VAT, duty draw back and other similar duties subsequently recovered/recoverable by the enterprise shall also be deducted.

5.2 Direct wages and salaries

Direct wages and salaries shall include house rent allowance, overtime and incentive payments made to employees directly engaged in the manufacturing activities.

Direct wages and salaries include fringe benefits such as:

- (i) Contribution to provident fund and ESIS
- (ii) Bonus/ ex-gratia payment to employees
- (iii) Provision for retirement benefits such as gratuity and superannuation
- (iv) Medical benefits
- (v) Subsidised food
- (vi) Leave with pay and holiday payment
- (vii) Leave encashment
- (viii) Other allowances such as children's education allowance, conveyance allowance which are payable to employees in the normal course of business etc.

5.3 Direct Expenses

Direct expenses are the expenses other than direct material cost and direct employees costs which can be identified with the product.

Direct expenses include:

- (i) Cost of utilities such as fuel, power, water, steam etc
- (ii) Royalty based on production
- (iii) Technical Assistance / know-how fees
- (iv) Amortized cost of moulds, patterns, patents etc
- (v) Job charges



- (vi) Hire charges for tools and equipment
- (vii) Charges for a particular product designing etc

5.4 Works Overheads

Works overheads are the indirect costs incurred in the production process.

Works overheads include the following expenses:

- (i) Consumable stores and spares
- (ii) Depreciation of plant and machinery, factory building etc
- (iii) Lease rent of production assets
- (iv) Repair and maintenance of plant and machinery, factory building etc
- (v) Indirect employees cost connected with production activities
- (vi) Drawing and Designing department cost.
- (vii) Insurance of plant and machinery, factory building, stock of raw material & WIP etc
- (viii) Amortized cost of jigs, fixtures, tooling etc
- (ix) Service department cost such as Tool Room, Engineering & Maintenance, Pollution Control etc

5.5 Quality Control Cost

The quality control cost is the expenses incurred relating to quality control activities for adhering to quality standard. These expenses shall include salaries & wages relating to employees engaged in quality control activity and other related expenses.

5.6 Research and Development Cost

The research and development cost incurred for development and improvement of the process or the existing product shall be included in the cost of production.

5.7 Administrative Overheads

Administrative overheads need to be analysed in relation to production activities and other activities. Administrative overheads in relation to production activities shall be included in the cost of production. Administrative overheads in relation to activities other than manufacturing activities e.g. marketing, projects management, corporate office expenses etc. shall be excluded from the cost of production.

5.8 Packing Cost

If product is transferred/dispached duly packed for captive consumption, cost of such packing shall be included.

Packing cost includes both cost of primary and secondary packing required for transfer/ dispatch of the goods used for captive consumption.

5.9 Absorption of overheads

Overheads shall be analysed into variable overheads and fixed overheads.

Variable Overheads are the items which change with the change in volume of production, such as cost of utilities etc.

Fixed overheads are the items whose value does not change with the change in volume of production such as salaries, rent etc.

The variable production overheads shall be absorbed in production cost based on actual capacity utilisation.

The fixed production overheads and other similar item of fixed costs such as quality control cost, research and development costs, administrative overheads relating to manufacturing shall be absorbed in the production cost on the basis of the normal capacity or actual capacity utilization of the plant, whichever is higher.

5.10 Valuation of Stock of work-in-progress and finished goods

Stock of work-in-progress shall be valued at cost on the basis of stages of completion as per the cost accounting principles. Similarly, stock of finished goods shall be valued at cost. Opening and closing stock of work-in-progress shall be adjusted for calculation of cost of goods produced and similarly opening and closing stock of finished goods shall be adjusted for calculation of goods despatched.

In case the cost of a shorter period is to be determined, where the figures of opening and closing stock are not readily available, the adjustment of figures of opening and closing stock may be ignored.

5.11 Treatment of Joint Products and By-Products

A production process may result in more than one product being produced simultaneously. In case joint products are produced, joint costs are allocated between the products on a rational and consistent basis. In case by-products are produced, the net realisable value of by-products is credited to the cost of production of the main product.

For allocation of joint cost to joint products, the sales values of products at the split off point i.e. when the products become separately identifiable may become the basis. Some other basis may be adopted. For example, in case of petroleum products, each product is assigned certain value based on its certain properties, may be calorific value and these values become the basis of apportionment of joint cost among petroleum products.

5.12 Treatment of Scrap and Waste

The production process may generate scrap or waste. Realized or realizable value of scrap or waste shall be credited to the cost of production.

In case, scrap or waste does not have ready market and it is used for reprocessing, the scrap or waste value is taken at a rate of input cost depending upon the stage at which such scrap or waste is recycled. The expenses incurred for making the scrap suitable for reprocessing shall be deducted from value of scrap or waste.

Illustration:

A production process has three stages.

<u>Stage</u>	<u>Input material cost</u>	<u>Processing cost</u>	<u>Total</u>
(₹ / MT)	(₹ / MT)	(₹ / MT)	
1	2000	500	2500
2	2500	1000	3500
3	3500	1000	4500

If during the production process at stage 3, the scrap is produced and the same is recycled at stage 2 after making an expenditure of ₹ 200 per MT to make it suitable for re-processing at stage 2, then scrap will be valued @ ₹ (2500 – 200) i.e ₹ 2300. If no expenditure is involved to make scrap re-usable, the scrap value will



be @ ₹ 2500. The scrap value for the scrap produced during a period calculated at the rate as explained above may be deducted to find out the cost of production for the period.

5.13 Miscellaneous Income

Miscellaneous income relating to production shall be adjusted in the calculation of cost of production, for example, income from sale of empty containers used for despatch of the captively consumed goods produced under reference.

5.14 Inputs received free of cost

In case any input material, whether of direct or indirect nature, including packing material is supplied free of cost by the user of the captive product, the landed cost of such material shall be included in the cost of production.

5.15 Moulds, Tools, Dies & Patterns etc received free of cost

The amortization cost of such items shall be included in the cost of production.

5.16 Interest and financial charges

Interest and financial charges being a financial charge shall not be considered to be a part of cost of production.

5.17 Abnormal and non-recurring cost

Abnormal and non-recurring cost arising due to unusual or unexpected occurrence of events, such as heavy break down of plants, accident, market condition restricting sales below normal level, abnormal idle capacity, abnormal process loss, abnormal scrap and wastage, payments like VRS, retrenchment compensation, lay-off wages etc. The abnormal cost shall not form the part of cost of production.

6. Cost Sheet

The cost sheet should be prepared in the format as per Appendix – 1 or as near thereto as possible. The manufacturer will be required to maintain cost records and other books of account in a manner, which would facilitate preparation and verification of the cost of production. For manufacturers covered under the ambit of Section 148(1) of the Companies Act, 2013, i.e., where Cost Accounting Records are statutorily required to be maintained, the Cost Accountant certifying the cost of production for captive consumption shall verify the correctness of the cost from these records. However, for manufacturers not covered under Section 148(1) of the Companies Act, 2013, it is desirable that they also maintain cost accounting records in line with the records so prescribed as to facilitate determination and certification of cost of production.

7. Disclosure

- (i) *If there is any change in cost accounting principles and practices during the concerned period which may materially affect the cost of production in terms of comparability with previous periods, the same should be disclosed.*
- (ii) *If opening stock and closing stock of work-in-progress and finished goods are not readily available for certification purpose, the same should be disclosed.*

Name of the Manufacturer :
 Address of the Manufacturer :
 Registration No of Manufacturer :
 Description of product captively consumed :
 Excise Tariff Heading :

Statement of Cost of Production of _____ manufactured / to be manufactured during the period _____

		Total Cost (₹)	Cost/ Unit (₹)
Q1	Quantity Produced (Unit of Measure)		
Q2	Quantity Despatched (Unit of Measure)		
	Particulars		
1	Material Consumed		
2	Direct Wages and Salaries		
3	Direct Expenses		
4	Works Overheads		
5	Quality Control Cost		
6	Research & Development Cost		
7	Administrative Overheads (relating to production activity)		
8	Total (1 to 7)		
9	Add : Opening stock of Work - in -Progress		
10	Less : Closing stock of Work -in- Progress		
11	Total (8+9-10)		
12	Less : Credit for Recoveries/Scrap/By-Products / misc income		
13	Packing cost		
14	Cost of production (11 - 12 + 13)		
15	Add: Inputs received free of cost		
16	Add: Amortised cost of Moulds, Tools, Dies & Patterns etc received free of cost		
17	Cost of Production for goods produced for captive consumption (14 + 15 + 16)		
18	Add : Opening stock of finished goods		
19	Less : Closing stock of finished goods		
20	Cost of production for goods despatched (17 + 18 - 19)		

Seal & Signature of Company's Authorised Representative

I/We, have verified above data on test check basis with reference to the books of account, cost accounting records and other records. Based on the information and explanations given to me/us, and on the basis of generally accepted cost accounting principles and practices followed by the industry, I /We certify that the above cost data reflect true and fair view of the cost of production.

Date :

Seal & Signature of Cost Accountant

Place :

Membership No.



Annexure to Appendix 1 (see Cost Accounting Standard 4)

Summary and Reconciliation of Excise Duty payable and paid on products captively consumed during the period ended _____			
Name of the Manufacturer			
Address of the Manufacturer			
Excise Registration Number			
Central Excise Tariff Heading			
Description of Product Captively Consumed		Installed Capacity as per ER-7	

	Period/Quarter	UOM	Total Production Quantity	Quantity transferred		Cost Of Goods Cleared During The Period As Per CAS-4 (₹)	Excise Duty Paid On The Basis Of CAS-4 (₹)	Excise Duty Payable during the period on the basis of audited accounts (₹)	Difference In Excise Duty Payable and Paid (₹)
				For Captive Consumption	For Other Than Captive Consumption				
1	First Period								
2	Second Period								
3	Third Period								
4	Fourth Period etc								
5	Total								

Date:

Seal & Signature of Company's Authorised Representative

I/We certify that the above summary and reconciliation statement have been prepared with reference to provisional / audited accounts, CAS-4 certificates, cost accounting standards and generally accepted cost accounting principles.

Date:

Seal & Signature of Cost Accountant

Membership No.

CAS -5
COST ACCOUNTING STANDARD
ON DETERMINATION OF
AVERAGE (EQUALIZED) COST OF TRANSPORTATION

The following is the text of the Cost Accounting Standard 5 (CAS-5) issued by the Council of the Institute of Cost & Works Accountants of India on "Determination of Average (Equalized) Cost of Transportation". This standard deals with the determination of average transportation cost of a product. In this standard the standard portions have been set in **bold italic** type. These are to be read in the context of the background material which has been set in the normal type.

1. Introduction:

1.1 The cost accounting principles for tracing/identifying an element of cost, its allocation/apportionment to a product or service are well established. Transportation cost is an important element of cost for procurement of materials for production and for distribution of product for sale. Therefore, Cost Accounting Records should present transportation cost separately from the other cost of inward materials or cost of sales of finished goods. The Finance Act 2003 also specifies the certification requirement of transportation cost for claiming deduction while arriving at the assessable value of excisable goods cleared for home consumption/ export. There is a need to standardize the record keeping of expenses relating to transportation and computation of transportation cost.

2. Objective

2.1 To bring uniformity in the application of principles and methods used in the determination of averaged/equalized transportation cost.

2.2 To prescribe the system to be followed for maintenance of records for collection of cost of transportation, its allocation/apportionment to cost centres, locations or products.

For example, transportation cost needs to be apportioned among excisable, exempted, non-excisable and other goods for arriving at the average of transportation cost of each class of goods.

2.3 To provide transparency in the determination of cost of transportation.

3. Scope

3.1 This standard should be applied for calculation of cost of transportation required under any statute or regulations or for any other purpose. For example, this standard can be used for :

- (a) determination of average transportation cost for claiming the deduction for arriving at the assessable value of excisable goods
- (b) Insurance claim valuation
- (c) Working out claim for freight subsidy under Fertilizer Industry Coordination Committee
- (d) Administered price mechanism of freight cost element
- (e) Determination of inward freight costs included or to be included in the cost of purchases attributable to the acquisition.
- (f) Computation of freight included in the value of inventory for accounting on inventory or valuation of stock hypothecated with Banks / Financial Institution, etc.

4. Definitions

The following terms are used in this standard with the meaning specified :

4.1 ***Cost of Transportation comprises of the cost of freight, cartage, transit insurance and cost of operating fleet and other incidental charges whether incurred internally or paid to an outside agency for transportation of goods but does not include detention and demurrage charges.***

Explanation :

Cost of transportation is classified as inward transportation cost and outward transportation Cost.



- 4.2 *Inward Transportation cost is the transportation expenses incurred in connection with materials /goods received at factory or place of use or sale/removal.*
- 4.3 *Outward Transportation cost is the transportation expenses incurred in connection with the sale or delivery of materials or goods from factory or depot or any other place from where goods are sold / removed*
- 4.4 *Freight is the charges paid or payable for transporting materials/ goods from one location to another.*
- 4.5 *Cartage is the expenses incurred for movement of goods covering short distance for further transportation for delivery to customer or storage.*
- 4.6 *Transit insurance cost is the amount of premium to be paid to cover the risk of loss /damage to the goods in transit.*
- 4.7 *Depot is the bounded premises /place managed internally or by an agent, including consignment agent and C & F agent, franchisee for storing of materials/goods for further dispatch including the premises of Consignment Agent and C&F Agent for the purpose.*
Depot includes warehouses, go-downs, storage yards, stock yards etc.
- 4.8 ***Equalized transportation cost means average transportation cost incurred during a specified period.***
- 4.9 ***Equalized freight means average freight.***
5. **Maintenance of records for ascertaining Transportation Cost**
- 5.1 *Proper records shall be maintained for recording the actual cost of transportation showing each element of cost such as freight, cartage, transit insurance and others after adjustment for recovery of transportation cost. Abnormal costs relating to transportation, if any, are to be identified and recorded for exclusion of computation of average transportation cost.*
- 5.2 ***In case of a manufacturer having his own transport fleet, proper records shall be maintained to determine the actual operating cost of vehicles showing details of various elements of cost, such as salaries and wages of driver, cleaners and others, cost of fuel, lubricant grease, amortized cost of tyres and battery, repairs and maintenance, depreciation of the vehicles, distance covered and trips made, goods hauled and transported to the depot.***
- 5.3 *In case of hired transport charges incurred for despatch of goods, complete details shall be recorded as to date of despatch, type of transport used, description of the goods, destination of buyer, name of consignee, challan number, quantity of goods in terms of weight or volume, distance involved, amount paid, etc.*
- 5.4 *Records shall be maintained separately for inward and outward transportation cost specifying the details particulars of goods despatched, name of supplier / recipient, amount of freight etc.*
- 5.5 ***Separate records shall be maintained for identification of transportation cost towards inward movement of material (procurement) and transportation cost of outward movement of goods removed /sold for both home consumption and export.***
- 5.6 *Records for transportation cost from factory to depot and thereafter shall be maintained separately.*
- 5.7 *Records for transportation cost for carrying any material / product to job-workers place and back should be maintained separately so as include the same in the transaction value of the product.*
- 5.8 *Records for transportation cost for goods involved exclusively for trading activities shall be maintained separately and the same will not be included for claiming any deduction for calculating assessable value excisable goods cleared for home consumption.*
- 5.9 *Records of transportation cost directly allocable to a particular category of products should be maintained separately so that allocation in appendix -3 can be made.*
- 5.10 ***For common transportation cost, both for own fleet or hired ones, proper records for basis of apportionment should be maintained.***
- 5.11 *Records for transportation cost for exempted goods, excisable goods cleared for export shall be maintained separately.*
- 5.12 *Separate records of cost for mode of transportation other than road like ship, air etc are to be maintained in appendix -2 which will be included in total cost of transportation.*

6. Treatment of cost:

6.1 *Inward transportation costs shall form the part of the cost of procurement of materials which are to be identified for proper allocation/ apportionment to the materials / products.*

6.2 *Outward transportation cost shall form the part of the cost of sale and shall be allocated / apportioned to the materials and goods on a suitable basis.*

Explanation :

Outward transportation cost of a product from factory to depot or any location of sale shall be included in the cost of sale of the goods available for sale.

6.3 *The following basis may be used, in order of priority, for apportionment of outward transportation cost depending upon the nature of products, unit of measurement followed and type of transport used :*

(i) Weight

(ii) Volume of goods

(iii) Tonne-Km

(iv) Unit / Equivalent unit

(v) Value of goods

(vi) Percentage of usage of space

Once a basis of apportionment is adopted, the same should be followed consistently.

6.4 *For determining the transportation cost per unit, distance shall be factored in to arrive at weighted average cost.*

6.5 *Abnormal and non recurring cost shall not be a part of transportation cost.*

Explanation

Penalty, detention charges, demurrage and cost related to abnormal break down will not be included in transportation cost.

7. Cost Sheet

The cost sheets shall be prepared and presented in a form as per Appendices 1,2 and 3 or as near thereto. Appendix 1 and Appendix 2 show the details of information to be maintained for compilation of transport cost for own fleet and hired transportation charges respectively. Appendix 1 is applicable where the organization is having its own fleet.

The directly allocable cost of own fleet (outward) shall be identified against different categories of products as shown in Appendix 3 and same shall be indicated there. Similarly, total common cost of own fleet (outward) shall be apportioned to different categories of products as shown in Appendix 3 on a basis which should be specified. The basis of apportionment may be adopted depending on the nature of product as indicated in para 6.3. Similar approach shall also be applied for hired outward transport charges.

More columns may be required to be shown in Appendix 3 specifying different types of transactions. For example : Sale on specific rate basis, sale of waste, scrap, return from customer, goods sent for job work, goods received after job work etc.

Unit of Measurement (UM) may vary depending upon the nature of the product. For example, Number, MT, Meter, Litre etc.

Proper records shall be maintained to show separately the Transportation Cost relating to sending of jobs to job contractors/convertors and receipt back of processed jobs/converted materials.

An enterprise shall be required to maintain cost records and other books of account in a manner which would facilitate preparation and verification of cost of transportation and other related charges and its apportioning to various products.

8. Transaction value :

'Transaction value' shall have the meaning assigned to it in Section 4 of The Central Excise Act, 1944 or Section 14 of The Customs Act , 1962 or as defined in any other Act or Regulations as the case may be.

9. The standard will be operative from the date of issue.



Appendix 1

Name of the Manufacturer:

Address of the Manufacturer:

Statement of Operating Cost of own Fleet for the period.....

SI No		
A	QUANTITATIVE INFORMATION	
A1	Number of Vehicles	
A2	Number of trips	
A3	Goods Transported – inward (UM)	
A4	Goods transported – outward (UM)	
A5	Goods transported – inward – Km	
A6	Goods transported – outward – Km	
A7	Total Goods transported inward – basis of apportionment (Specify)	
A8	Total Goods transported outward – basis of apportionment (Specify)	
A9	Total (A7+A8)	
B	COST INFORMATION	(₹)
	Cost of Operation	
	Variable Cost	
B1.	Salaries & Wages of Drivers, Cleaners and others	
B2.	Fuel & Lubricants	
B3.	Consumables	
B4.	Amortized cost of Tyre, Tube & Battery	
B5.	Spares	
B6.	Repair & Maintenance	
B7.	Other Variable Cost (specify)	
B8.	Total Variable Cost (B1 to B7)	
	Fixed Cost	
B9.	Insurance	
B10.	Licence Fee, Permit Fee and Taxes	
B11.	Depreciation	
B12.	Other Fixed Costs (Specify)	
B13.	Total Fixed Cost (B9 to B12)	
B14.	Total Operating Cost (B8+B13)	
C	APPORTIONMENT (Basis to be specified) - usage	
C1.	Inward Transport Cost (B14 * A7/ A9)	
C2.	Outward Transport Cost (B14 * A8/A9)	
C3.	Transit insurance for inward movement	
C4.	Transit insurance for outward movement	
C5.	Total transportation cost for inward movement (C1+C3)	
C6.	Total transportation cost for outward movement (C2+C4)	

Note :

1. Cost of Battery, and Tyres and Tubes shall to be amortised over its useful life.
2. Asset Register shall be maintained for determination of depreciation and amortization cost.
3. Separate Cost Sheet shall be prepared for different types of vehicles

Name of the Manufacturer:

Address of the Manufacturer:

Statement of Hired Outward Transportation Cost for the period ending.....

A	Quantitative Information	
A1	Quantity of goods transported – outward (UM)	
B	(COST INFORMATION)	(₹)
B1	Hired Transport Charges	
B2	Transit Insurance	
B3	Other (specify)	
B4	Total Transportation cost (B1 to B3)	

Name of the Manufacturer:

Address of the Manufacturer:

Statement of apportionment of Outward Transportation Cost to different goods and Determination of Averaged Outward Transport Cost for the period ending.....

A	Quantitative Information	Total	Excisable goods			Specific Rated Goods	Goods Cleared for Export	Exempted Goods	Goods Cleared On MRP Basis	Goods Cleared from Factory to Customer	Goods Cleared from Depot to Customer	Others
			Product-Group 1	Product-Group 2	Product-Group 3							
A1	Goods transported Outwards (UM *)											
A2	Goods Transported Outward (KM)											
B	Outward Transport Cost (₹)											
B1	Directly allocated own fleet transportation cost (₹)											
B2	Basis of Apportionment of own fleet Cost (Specify)											
B3	Common own fleet transport cost to be apportioned											



B4	Directly allocated hired transportation charges (₹)											
B5	Basis of Apportionment of hired transportation cost (Specify)											
B6	Common hired transport charges to be apportioned											
B7	Total Transport Cost (B1+ B3+ B4 + B6)											
B8	Averaged transport cost per unit (B7/A1) (₹)											

* UM is the Unit of measurement

Seal and signature of Company's authorized representative

I /We, have verified above data and calculation in the appendix 1, 2 and 3 on test check basis with reference to the books of account, cost accounting records and other records. Based on the information and explanations given to me/us, and on the basis of generally accepted cost accounting principles and practices followed by the industry, I /We certify that the above cost data reflect true and fair view of averaged transport cost.

Date:

Place:

Seal & Signature of Cost Accountant

Membership No.

CAS-6

COST ACCOUNTING STANDARD ON MATERIAL COST

The following is the COST ACCOUNTING STANDARD 6 (CAS 6) issued by the Council of The Institute of Cost Accountants of India on "MATERIAL COST". In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material, which has been set in normal type.

1. Introduction

1.1 This standard deals with principles and methods of determining the Material Cost.

Material for the purpose of this standard includes raw materials, process materials, additives, manufactured / bought out components, sub-assemblies, accessories, semi finished goods, consumable stores, spares and other indirect materials. This standard does not deal with Packing Materials as a separate standard is being issued on the subject.

1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of material cost, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.***

1.3 The Standard deals with the following issues.

- Principle of Valuation of receipt of materials.
- Principle of Valuation of issue of materials.
- Assignment of material cost to cost objects.

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the material cost with reasonable accuracy.

3. Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of material costs including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/ or due to some abnormal situation of the production or operation (Adapted from CAS-1 Para 6.5.19).***

4.2 ***Administrative overheads: Cost of all activities relating to general management and administration of an entity.***

4.3 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.4 ***Defectives: Materials, products or intermediate products that do not meet quality standards. This may include reworks or rejects.***

4.4.1 ***Reworks: Defectives which can be brought up to the standards by putting in additional resources.***

Rework includes repairs, reconditioning and refurbishing.

4.4.2 ***Rejects: Defectives which cannot meet the quality standards even after putting in additional resources.***

Rejects may be disposed off as waste or sold for salvage value or recycled in the production process.

4.5 ***Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose.***



4.6 **Intermediate Product:** *An intermediate product is a product that requires further processing before it is saleable.*

4.7 **Materials:**

4.7.1 **Direct Materials:** *Materials the costs of which can be attributed to a cost object in an economically feasible way (Adapted from CAS 1-6.2.3).*

4.7.2 **Indirect Materials:** *Materials, the costs of which cannot be directly attributed to particular cost object (Adapted from CAS 1– 6.2.8).*

4.8 **Material Cost:** *The cost of material used for the purpose of production of a product or rendering a service.*

4.9 **Production overheads:** *Indirect costs involved in the production of a product or in rendering service*

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

4.10 **Scrap:** *Discarded material having no or insignificant value and which is usually either disposed off without further treatment (other than reclamation and handling) or reintroduced into the process in place of raw material.*

4.11 **Standard Cost:** *A predetermined cost of a product or service based on technical specifications and efficient operating conditions*

The standard cost serves as a basis of cost control and as a measure of productive efficiency when ultimately posed with an actual cost. It provides management with a medium by which the effectiveness of current results is measured and responsibility for deviation is placed (Adapted from CAS 1_ Para 6.7.5). Standard costs are used to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them.

4.12 **Waste and spoilage:**

4.12.1 **Waste:** *Material lost during production or storage and discarded material which may or may not have any value.*

4.12.2 **Spoilage:** *Production that does not meet the quality requirements or specifications and cannot be rectified economically.*

5. **Principles of Measurement**

5.1. **Principle of valuation of receipt of materials:**

5.1.1 *The material receipt should be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited by the taxing authorities) that can be quantified with reasonable accuracy at the time of acquisition.*

Examples of taxes and duties to be deducted from cost are cenvat credits, credit for countervailing customs duty, sales tax set off/ vat credits and other similar items of credit recovered/ recoverable.

5.1.2 *Finance costs incurred in connection with the acquisition of materials shall not form part of material cost.*

5.1.3 *Self manufactured materials shall be valued including direct material cost, direct employee cost, direct expenses, factory overheads, share of administrative overheads relating to production but excluding share of other administrative overheads, finance cost and marketing overheads. In case of captive consumption, the valuation shall be in accordance with Cost Accounting Standard 4.*

- 5.1.4 **Spares which are specific to an item of equipment shall not be taken to inventory, but shall be capitalized with the cost of the specific equipment. Cost of capital spares and/or insurance spares, whether procured with the equipment or subsequently, shall be amortised over a period, not exceeding the useful life of the equipment.**
- 5.1.5 **Normal loss or spoilage of material prior to reaching the factory or at places where the services are provided shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal.**
- 5.1.6 **Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture etc., before the material is received shall be absorbed in material cost to the extent they are normal, with corresponding adjustment in the quantity.**

The adjustment for moisture will depend on whether dry weight is used for measurement.

- 5.1.7 **The forex component of imported material cost shall be converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise shall not form part of the material cost.**

Explanation: The date on which a transaction (whether for goods or services) is recognised in accounting in conformity with generally accepted accounting principles.

- 5.1.8 **Any demurrage or detention charges, or penalty levied by transport or other authorities shall not form part of the cost of materials.**
- 5.1.9 **Subsidy/Grant/Incentive and any such payment received/receivable with respect to any material shall be reduced from cost for ascertainment of the cost of the cost object to which such amounts are related.**

5.2 Principle of valuation of issue of material

- 5.2.1 **Issues shall be valued using appropriate assumptions on cost flow.**

E.g. First In First Out, Last In First Out, Weighted Average Rate.

The method of valuation shall be followed on a consistent basis.

- 5.2.2 **Where materials are accounted at standard cost, the price variances related to materials shall be treated as part of material cost.**
- 5.2.3 **Any abnormal cost shall be excluded from the material cost.**
- 5.2.4 **Wherever, material costs include transportation costs, determination of costs of transportation shall be governed by CAS 5 – Cost Accounting Standard on Determination of Average (Equalized) Cost of Transportation.**
- 5.2.5 **Material cost may include imputed costs not considered in financial accounts.** Such costs which are not recognized in financial accounts may be determined by imputing a cost to the usage or by measuring the benefit from an alternate use of the resource.

- 5.3 **Self manufactured components and sub-assemblies shall be valued including direct material cost, direct employee cost, direct expenses, factory overheads, share of administrative overheads relating to production but excluding share of other administrative overheads, finance cost and marketing overheads. In case of captive consumption, the valuation shall be in accordance with Cost Accounting Standard 4.**

- 5.4 **The material cost of normal scrap/ defectives which are rejects shall be included in the material cost of goods manufactured. The material cost of actual scrap / defectives, not exceeding the normal shall be adjusted in the material cost of good production. Material Cost of abnormal scrap /defectives should not be included in material cost but treated as loss after giving credit to the realisable value of such scrap / defectives.**



6. Assignment of costs

The basis of assignment of costs to the cost of product or service is dealt within this section.

6.1 Assignment of costs – Materials

6.1.1 *Assignment of material costs to cost objects: Material costs shall be directly traced to a Cost object to the extent it is economically feasible and /or shall be assigned to the cost object on the basis of material quantity consumed or similar identifiable measure and valued as per the principles laid under Paragraph 5.*

6.1.2 *Where the material costs are not directly traceable to the cost object, these may be assigned on a suitable basis like technical estimates.*

6.2 Assignment of costs – Direct Expenses

6.2.1 *Where a material is processed or part manufactured by a third party according to specifications provided by the buyer, the processing/ manufacturing charges payable to the third party shall be treated as part of the material cost.*

6.2.2 *Wherever part of the manufacturing operations / activity is subcontracted, the subcontract charges related to materials shall be treated as direct expenses and assigned directly to the cost object.*

6.3 Assignment of costs– Indirect materials

6.3.1 *The cost of indirect materials shall be assigned to the various Cost objects based on a suitable basis such as actual usage or technical norms or a similar identifiable measure.*

6.3.2 *The cost of materials like catalysts, dies, tools, moulds, patterns etc, which are relatable to production over a period of time shall be amortized over the production units benefited by such cost.*

6.3.3 *The cost of indirect material with life exceeding one year shall be included in cost over the useful life of the material.*

7. Presentation

Cost Statements governed by this standard, shall present material costs as detailed below:

7.1 *Direct Materials shall be classified in the cost statement under suitable heads.*

E.g.

- Raw materials,
- Components,
- Semi finished goods and
- Sub-assemblies

7.2 *Direct Materials shall be classified as Purchased - indigenous, imported and self manufactured.*

7.3 *Indirect Materials shall be classified in the cost statement under suitable heads.*

Indirect materials may be grouped under major heads like tools, stores and spares, machinery spares, jigs and fixtures, consumable stores, etc., if they are significant.

8. Disclosures

The following information should be disclosed in the cost statements dealing with determination of material cost.

- 8.1 **Quantity and rates of major items of materials shall be disclosed. Major items are defined as those who form 5% of cost of materials.**
- 8.2 *The basis of valuation of materials shall be disclosed.*
- 8.3 *Any change in the cost accounting principles and methods applied for the determination of the material cost during the period covered by the cost statement which has a material effect on the cost of the material shall be disclosed. Where the effect of such change is not ascertainable wholly or partly, the fact shall be indicated.*
- 8.4 *Any abnormal cost excluded from the material cost shall be disclosed.*
- 8.5 *Any demurrage or detention charges, penalty levied by transport or other authorities excluded from the material cost shall be disclosed.*
- 8.6 *Any Subsidy/Grant/Incentive or any such payment reduced from material cost shall be disclosed.*
- 8.7 **Cost of Materials procured from related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of statements) shall be disclosed**
- 8.8 *Any cost imputed in arriving at the material cost shall be disclosed.*
- 8.9 **Disclosures shall be made only where significant, material and quantifiable.**
- 8.10 *Disclosures may be made in the body of the Cost statement or as a footnote or as a separate schedule.*



CAS – 7

COST ACCOUNTING STANDARD ON EMPLOYEE COST

The following is the COST ACCOUNTING STANDARD 7 (CAS - 7) issued by the Council of The Institute of Cost Accountants of India on “EMPLOYEE COST”. In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material, which has been set in normal type.

1. Introduction

1.1 This standard deals with the principles and methods of determining the Employee cost.

1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of Employee cost, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.***

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Employee cost with reasonable accuracy.

3. Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Employee cost including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/ or due to some abnormal situation of the production or operation (Adapted from CAS 1 paragraph 6.5.19).***

4.2 ***Abnormal Idle time: An unusual or atypical idle time occurrence of which is irregular and unexpected or due to some abnormal situations.***

E.g.: Idle time due to a strike, lockout or an accident

4.3 ***Administrative overheads: Cost of all activities relating to general management and administration of an entity.***

4.4 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.5 ***Direct Employee Cost: Employee cost, which can be attributed to a Cost object in an economically feasible way (Adapted from CAS 1 paragraph 6.2.4 (Direct labour cost)).***

4.6 ***Distribution Overheads: Distribution overheads, also known as distribution costs, are the costs incurred in handling a product or service from the time it is ready for despatch or delivery until it reaches the ultimate consumer including the units receiving the product or service in an inter-unit transfer***

The cost of any non manufacturing operations such as packing, repacking, labelling, etc. at an intermediate storage location will be part of distribution cost.

4.7 ***Employee cost: Benefits paid or payable for the services rendered by employees (including temporary, part time and contract employees) of an entity.***

Explanation:

1. Contract employees include employees directly engaged by the employer on contract basis but does not include employees of any contractor engaged in the organisation.

2. Compensation paid to employees for the past period on account of any dispute / court orders shall not form part of Employee Cost.
3. Short provisions of prior period made up in current period shall not form part of the employee cost in the current period.

Employee cost includes payment made in cash or kind.

For example:

Employee cost

- Salaries, wages, allowances and bonus / incentives.
- Contribution to provident and other funds.
- Employee welfare
- Other benefits

Employee cost – Future benefits

- Gratuity.
- Leave encashment.
- Other retirement/separation benefits.
- VRS/ other deferred Employee cost.
- Other future benefits

Benefits generally include

- Paid holidays.
- Leave with pay.
- Statutory provisions for insurance against accident or health scheme.
- Statutory provisions for workman's compensation.
- Medical benefits to the Employees and dependents.
- Free or subsidised food.
- Free or subsidised housing.
- Free or subsidised education to children.
- Free or subsidised canteen, crèches and recreational facilities.
- Free or subsidised conveyance.
- Leave travel concession.
- Any other free or subsidised facility.
- Cost of Employees' stock option.

4.8 Idle time: The difference between the time for which employees are paid /payable to employees and the employees' time booked against cost objects.

The time for which the employees are paid includes holidays, paid leave and other allowable time offs such as lunch, tea breaks.

4.9 Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose.

4.10 Indirect Employee Cost: Employee cost, which can not be directly attributed to a particular cost object (Adapted from CAS 1 paragraph 6.2.10).



4.11 **Marketing overheads:** Marketing overheads comprise of selling overheads and distribution overheads.

4.12 **Overtime Premium:** The extra amount payable beyond the normal wages and salaries for beyond the normal working hours.

4.13 **Production Overheads:** Indirect costs involved in the production of a product or in rendering service.

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

4.14 **Selling Overheads:** Selling overheads are the expenses related to sale of products or services and include all indirect expenses incurred in selling the products or services.

4.15 **Standard Cost:** A predetermined cost of a product or service based on technical specifications and efficient operating conditions.

Standard costs are used as scale of reference to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

5. Principles of Measurement

5.1 **Employee Cost shall be ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all the benefits.**

5.2 **Bonus whether payable as a Statutory Minimum or on a sharing of surplus shall be treated as part of employee cost. Ex gratia payable in lieu of or in addition to Bonus shall also be treated as part of the employee cost.**

5.3 **Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute will be considered as part of the Employee Cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits.**

Explanation: Remuneration paid to non executive directors shall not form part of Employee Cost but shall form part of Administrative Overheads.

5.4 **Separation costs related to voluntary retirement, retrenchment, termination etc. shall be amortised over the period benefitting from such costs.**

5.5 **Employee cost shall not include imputed costs.**

5.6 **Cost of Idle time is ascertained by the idle hours multiplied by the hourly rate applicable to the idle employee or a group of employees.**

5.7 **Where Employee cost is accounted at standard cost, variances due to normal reasons related to Employee cost shall be treated as part of Employee cost. Variances due to abnormal reasons shall be treated as part of abnormal cost.**

5.8 **Any Subsidy, Grant, Incentive or any such payment received or receivable with respect to any Employee cost shall be reduced for ascertainment of cost of the cost object to which such amounts are related.**

5.9 **Any abnormal cost where it is material and quantifiable shall not form part of the Employee cost.**

5.10 **Penalties, damages paid to statutory authorities or other third parties shall not form part of the Employee cost.**

5.11 **The cost of free housing, free conveyance and any other similar benefits provided to an employee shall be determined at the total cost of all resources consumed in providing such benefits.**

5.12 **Any recovery from the employee towards any benefit provided e.g. housing shall be reduced from the employee cost.**

5.13 **Any change in the cost accounting principles applied for the determination of the Employee cost should be made only if it is required by law or for compliance with the requirements of a cost accounting standard or a change would result in a more appropriate preparation or presentation of cost statements of an enterprise.**

6. Assignment of costs

- 6.1 **Where the Employee services are traceable to a cost object, such Employees' cost shall be assigned to the cost object on the basis such as time consumed or number of employees engaged etc or similar identifiable measure.**
- 6.2 *While determining whether a particular Employee cost is chargeable to a separate cost object, the principle of materiality shall be adhered to.*
- 6.3 *Where the Employee costs are not directly traceable to the cost object, these may be assigned on suitable basis like estimates of time based on time study.*
- 6.4 *The amortised separation costs related to voluntary retirement, retrenchment, and termination etc. for the period shall be treated as indirect cost and assigned to the cost objects in an appropriate manner. However unamortised amount related to discontinued operations, shall not be treated as employee cost.*
- 6.5 *Recruitment costs, training cost and other such costs shall be treated as overheads and dealt with accordingly.*
- 6.6 *Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime.*
- 6.7 *Idle time cost shall be assigned direct to the cost object or treated as overheads depending on the economic feasibility and the specific circumstances causing such idle time.*

Cost of idle time for reasons anticipated like normal lunchtime, holidays etc is normally loaded in the Employee cost while arriving at the cost per hour of an Employee/a group of Employees whose time is attributed direct to cost objects.

7. Presentation

- 7.1 *Direct Employee costs shall be presented as a separate cost head in the cost statement.*
- 7.2 *Indirect Employee costs shall be presented in cost statements as a part of overheads relating to respective functions e.g. manufacturing, administration, marketing etc.*
- 7.3 *The cost statement shall furnish the resources consumed on account of Employee cost, category wise such as wages salaries to permanent, temporary, part time and contract employees piece rate payments, overtime payments, Employee benefits (category wise)etc. wherever such items form a material part of the total Employee cost.*

8. Disclosures

- 8.1 *The cost statements shall disclose the following:*
 1. *Employee cost attributable to capital works or jobs in the nature of deferred revenue expenditure indicating the method followed in determining the cost of such capital work.*
 2. *Separation costs payable to employees.*
 3. *Any abnormal cost excluded from Employee cost.*
 4. *Penalties and damages paid etc excluded from Employee cost.*
 5. *Any Subsidy, Grant, Incentive and any such payment reduced from Employee cost*
 6. *The Employee cost paid to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).*
 7. *Employee cost incurred in foreign exchange.*
- 8.2 *Any change in the cost accounting principles and methods applied for the measurement and assignment of the Employee Cost during the period covered by the cost statement which has a material effect on the Employee Cost. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*
- 8.3 **Disclosures shall be made only where material, significant and quantifiable.**
- 8.4 *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*



CAS-8

COST ACCOUNTING STANDARD ON COST OF UTILITIES

The following is the COST ACCOUNTING STANDARD – 8 (CAS-8) issued by the Council of The Institute of Cost Accountants of India on "COST OF UTILITIES", for comments. In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material which has been set in normal type.

1. Introduction

1.1 This standard deals with the principles and methods of determining the cost of utilities.

1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of cost of utilities, for determination of the cost of product or service, and the presentation and disclosure in cost statements.***

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the cost of utilities with reasonable accuracy.

3. Scope

3.1 ***This standard shall be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of cost of utilities including those requiring attestation.***

3.2 *For determining the cost of production to arrive at an assessable value of excisable utilities used for captive consumption, Cost Accounting Standard 4 on Cost of Production for Captive Consumption (CAS4) shall apply.*

3.3 ***This standard shall not be applicable to the organizations primarily engaged in generation and sale of utilities.***

3.4 *This standard does not cover issues related to the ascertainment and treatment of carbon credits, which shall be dealt with in a separate standard.*

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/ or due to some abnormal situation of the production or operation (Adapted from CAS 1 paragraph 6.5.19).***

4.2 ***Committed Cost: The cost of maintaining stand-by utilities shall be the committed cost.***

4.3 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.4 ***Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose.***

4.5 ***Interest and Finance charges: Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.***

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology). The terms Finance costs and Borrowing costs are used interchangeably.

- 4.6 **Normal capacity:** *Normal Capacity is the production achieved or achievable on an average over a number of periods or seasons under normal circumstances taking into account the loss of capacity resulting from planned maintenance (Adapted from CAS 2 paragraph 4.4).*

In case of any standby utility the normal capacity will be the same as actual production of the utility.

The normal capacity of a utility meant for captive consumption would be based on the normal capacity for the production facility of the end product of the consuming unit.

- 4.7 **Standard Cost:** *A predetermined cost of a product or service based on technical specifications and efficient operating conditions.*

Standard costs are used as scale of reference to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

- 4.8 **Stand-by utilities:** *Any utility created as backup against any failure of the main source of utilities.*

- 4.9 **Utilities:** *Significant inputs such as power, steam, water, compressed air and the like which are used for manufacturing process but do not form part of the final product.*

5. Principles of measurement

- 5.1 *Each type of utility shall be treated as a distinct cost object.*

- 5.2 *Cost of utilities purchased shall be measured at cost of purchase including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified with reasonable accuracy at the time of acquisition.*

5.3.1 *Cost of self generated utilities for own consumption shall comprise direct material cost, direct employee cost, direct expenses and factory overheads.*

5.3.2 *In case of Utilities generated for the purpose of inter unit transfers, the distribution cost incurred for such transfers shall be added to the cost of utilities determined as per paragraph 5.3.1.*

5.3.3 *Cost of Utilities generated for the inter company transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads.*

5.3.4 *Cost of Utilities generated for the sale to outside parties shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost, share of administrative overheads and marketing overheads.*

The sale value of such utilities will also include the margin.

- 5.4 *Finance costs incurred in connection with the utilities shall not form part of cost of utilities.*

- 5.5 *The cost of utilities shall include the cost of distribution of such utilities.*

The cost of distribution will consist of the cost of delivery of utilities up to the point of consumption.

- 5.6 *Cost of utilities shall not include imputed costs.*

- 5.7 *Where cost of utilities is accounted at standard cost, the price variances related to utilities shall be treated as part of cost of utilities and the portion of usage variances due to normal reasons shall be treated as part of cost of utilities. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.*

- 5.8 *Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to any cost of utilities shall be reduced for ascertainment of the cost to which such amounts are related.*

- 5.9 *The cost of production and distribution of utilities shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost (Adapted from paragraph 5.7 of CAS 3). Cost of a Stand-by Utility shall include the committed costs of maintaining such a utility.*



- 5.10 **Any abnormal cost where it is material and quantifiable shall not form part of the cost of utilities.**
- 5.11 *Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of utilities.*
- 5.12 **Credits/recoveries relating to the utilities including cost of utilities provided to outside parties, material and quantifiable, shall be deducted from the total cost of utility to arrive at the net cost of utility.**
- 5.13 *Any change in the cost accounting principles applied for the measurement of the cost of utilities should be made only if, it is required by law or for compliance with the requirements of a cost accounting standard, or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.*
6. **Assignment of costs**
- 6.1 *While assigning cost of utilities, traceability to a cost object in an economically feasible manner shall be the guiding principle.*
- 6.2 *Where the cost of utilities is not directly traceable to cost object, it shall be assigned on the most appropriate basis.*
- 6.3 *The most appropriate basis of distribution of cost of a utility to the departments consuming services is to be derived from usage parameters.*
7. **Presentation**
- 7.1 *Utilities costs shall be presented as a separate cost head for each type of utility in the cost statement, if material.*
- 7.2 **Where separate cost statements are prepared for utilities, cost of utilities shall be classified as purchased or generated. Such statement shall also include cost of utilities consumed along with quantitative information by individual consuming units, inter unit transfers, inter company transfers and sale to outside parties wherever applicable.**
8. **Disclosures**
- 8.1 *The cost statements shall disclose the following:*
1. *The basis of distribution of Cost of Utility to the consuming centres.*
 2. *The cost of purchase, production, distribution, marketing and price with reference to sales to outside parties.*
 3. *Where cost of utilities is disclosed at standard cost, the price and usage variances.*
 4. *The cost and price of Utility received from/supplied to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).*
 5. *The cost and price of Utility received from/supplied as inter unit transfers and intercompany transfers*
 6. *Cost of utilities incurred in foreign exchange.*
 7. *Any Subsidy/Grant/Incentive and any such payment reduced from Cost of utilities.*
 8. *Credits/recoveries relating to the Cost of utilities.*
 9. *Any abnormal cost excluded from Cost of utilities.*
 10. *Penalties and damages paid etc excluded from cost of utilities.*
- 8.2 *Any change in the cost accounting principles and methods applied for the measurement and assignment of the Cost of utilities during the period covered by the cost statement which has a material effect on the Cost of utilities. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*
- 8.3 **Disclosures shall be made only where material, significant and quantifiable.**
- 8.4 *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*

CAS 9

COST ACCOUNTING STANDARD ON PACKING MATERIAL COST

The following is the COST ACCOUNTING STANDARD - (CAS - 9) issued by the Council of The Institute of Cost Accountants of India on "PACKING MATERIAL COST", for comments. In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material which has been set in normal type.

1. Introduction

1.1 This standard deals with the principles and methods of determining the Packing Material Cost.

1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of Packing Material Cost, for determination of the cost of product, and the presentation and disclosure in cost statements.***

1.3 ***Packing Materials for the purpose of this standard are classified into primary and secondary packing materials.***

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the packing material cost with reasonable accuracy.

3. Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of Packing Material Cost including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/or due to some abnormal situation of the production or operation (Adapted from CAS 1 Para 6.5.19).***

For example: the cost of packing material which is rejected after issue due to abnormal causes such as misprinting, use of material of wrong specification etc. (net of realisable value) may be treated as abnormal cost.

4.2 ***Administrative Overheads: Cost of all activities relating to general management and administration of an entity.*** Administrative overheads shall exclude any overhead relating to production, operations and marketing.

4.3 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.4 ***Direct Employee Cost: Employee cost, which can be attributed to a cost object in an economically feasible way (Adapted from CAS 7 Para 4.6).***

4.5 ***Direct Expenses: Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material or direct employee cost (Adapted from CAS 1 Para 6.2.6 and also proposed in the CAS on Direct Expenses).*** Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.



4.6 Direct Materials: *Materials, the costs of which can be attributed to a cost object in an economically feasible way.*

4.7 Distribution Overheads: *Distribution overheads, also known as distribution costs, are the costs incurred in handling a product or service from the time it is ready for despatch or delivery until it reaches the ultimate consumer including the units receiving the product or service in an inter-unit transfer.*

For example:

- Secondary packing
- Transportation cost
- Warehousing cost
- Cost of delivering the products to customers etc.
- Clearing and forwarding charges
- Cost of mending or replacing packing materials at distribution point.

4.8 Imputed Costs: *Notional cost, not involving cash outlay, computed for any purpose.*

For example: packing material supplied by the customer.

4.9 Interest and Finance charges: *Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.*

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology). The terms Finance costs and Borrowing costs are used interchangeably.

4.10 Marketing overheads: *Marketing Overheads comprise of selling overheads and distribution overheads.*

4.11 Packing Materials: *Materials used to hold, identify, describe, store, protect, display, transport, promote and make the product marketable.*

4.11.1 Defectives: *Materials, products or intermediate products that do not meet quality standards. This may include reworks or rejects.*

4.11.1.1 Reworks: *Defectives which can be brought up to the standards by putting in additional resources (Adapted from CAS 6 Para 4.4.1).*

Rework includes repairs, reconditioning and refurbishing.

4.11.1.2 Rejects: *Defectives which can not meet the quality standards even after putting in additional resources (Adapted from CAS 6 Para 4.4.2).*

Rejects may be disposed off as waste or sold for salvage value or recycled in the production process.

4.11.2 Packing Material Cost: *The cost of material of any nature used for the purpose of packing of a product.*

4.11.3 Primary Packing Material: *Packing material which is essential to hold and preserve the product for its use by the customer.*

For example:

- Pharmaceutical industry: Insertions related to product, Foils for strips of tablets/capsules, vials.

- Industrial gases: Cylinders / bottles used for filling the gaseous products
- Confectionary Industry: Butter paper and wrappers.

4.11.4 Reusable Packing Material: Packing materials that are used more than once to pack the product.

4.11.5 Scrap: Discarded material having no or insignificant value and which is usually either disposed off without further treatment (other than reclamation and handling) or reintroduced into the process in place of raw material.

4.11.6 Secondary Packing Material: Packing material that enables to store, transport, inform the customer, promote and otherwise make the product marketable.

For example:

- Pharmaceutical industry: Cartons used for holding strips of tablets and card board boxes used for holding cartons.
- Textile industry: Card board boxes used for holding cones on which yarn is woven.
- Confectionary Industry: Jars for holding wrapped chocolates, Cartons containing packs of biscuits.

4.12 Packing Material Development Cost: Cost of evaluation of packing material such as pilot test, field test, consumer research, feed back, and final evaluation cost.

4.13 Production overheads: Indirect costs involved in the production of a product or in rendering service.

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably. Production overheads shall include administration cost relating to production, factory, works or manufacturing.

4.14 Selling Overheads: Selling overheads are the expenses related to sale of products or services and include all indirect expenses incurred in selling the products or services.

4.15 Standard Cost: A predetermined cost of a product or service based on technical specifications and efficient operating conditions.

Standard costs are used as scale of reference to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

5. Principles of Measurement

5.1 Principle of valuation of receipts of packing material:

5.1.1 The packing material receipts should be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified at the time of acquisition.

Examples of taxes and duties to be deducted from cost are CENVAT credits, credit for countervailing customs duty, sales tax set off/ vat credits and other similar items of credit recovered/ recoverable.

5.1.2 Finance costs directly incurred in connection with the acquisition of Packing Material shall not form part of Packing Material Cost.

5.1.3 Self manufactured packing materials shall be valued including direct material cost, direct employee cost, direct expenses, job charges, factory overheads including share of administrative overheads comprising factory management and administration and share of research and development cost incurred for development and improvement of existing process or product.



5.1.4 *The valuation of captive consumption of packing materials shall be in accordance with paragraph 5 of Cost Accounting Standard 4.*

5.1.5 *Normal loss or spoilage of packing material prior to receipt in the factory shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal.*

5.1.6 *The forex component of imported packing material cost shall be converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise shall not form part of the packing material cost.*

Explanation: The date on which a transaction (whether for goods or services) is recognised in accounting in conformity with generally accepted accounting principles.

5.1.7 *Any demurrage, detention charges or penalty levied by the transport agency or any authority shall not form part of the cost of packing materials.*

5.1.8 *Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to packing material shall be reduced for ascertainment of the cost to which such amounts are related.*

5.2 Principle of valuation of issue of packing material

Issues shall be valued using appropriate assumptions on cost flow.

For example: First In First Out, Last In First Out, Weighted Average Rate.

The method of valuation shall be followed on a consistent basis.

5.3 *Wherever, packing material costs include transportation costs, determination of costs of transportation shall be governed by CAS 5 – Cost Accounting Standard on determination of average (equalized) cost of transportation.*

5.4 *Packing Material Costs shall not include imputed costs. However in case of Cost of Production of Excisable Goods for Captive Consumption the computation of cost shall be as per CAS 4.*

5.5 *Where packing materials are accounted at standard cost, the price variances related to such materials shall be treated as part of packing material cost and the portion of usage variances due to normal reasons shall be treated as part of packing material cost. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.*

5.6 *The normal loss arising from the issue or consumption of packing materials shall be included in the packing materials cost.*

5.7 *Any abnormal cost where it is material and quantifiable shall be excluded from the packing material cost.*

5.8 *The credits/recoveries in the nature of normal scrap arising from packing materials if any, should be deducted from the total cost of packing materials to arrive at the net cost of packing materials.*

6. Assignment of Cost

6.1 *Assignment of packing material costs to cost objects: Packing material costs shall be directly traced to a cost object to the extent it is economically feasible.*

6.2 *Where the packing material costs are not directly traceable to the cost object, these may be assigned on the basis of quantity consumed or similar measures like technical estimates.*

6.3 *The packing material cost of reusable packing shall be assigned to the cost object taking into account the number of times or the period over which it is expected to be reused.*

- 6.4 *Cost of primary packing materials shall form part of the cost of production.*
- 6.5 *Cost of secondary packing materials shall form part of distribution overheads.*

7. **Presentation**

- 7.1 ***Packing Materials shall be classified as primary and secondary and within this classification as purchased – indigenous, imported and self manufactured.***
- 7.2 ***Where separate cost statements are prepared for packing costs, the cost of packing materials consumed shall be presented in terms of type of packing in which the materials are used (For example; Bale, Bag, Carton, Pallet). Such statements shall also include cost and quantitative information, wherever it is found material and quantifiable.***

8. **Disclosures**

- 8.1 *The cost statements shall disclose the following:*
 - 1. *The basis of valuation of Packing Materials.*
 - 2. *Where Packing Materials Cost is disclosed at standard cost, the price and usage variances.*
 - 3. *The cost and price of Packing Materials received from/supplied to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).*
 - 4. *Packing Materials cost incurred in foreign exchange.*
 - 5. *Any Subsidy/Grant/Incentive and any such payment reduced from Packing Materials Costs.*
 - 6. *Credits/recoveries relating to the Packing Materials Costs.*
 - 7. *Any abnormal cost excluded from Packing Materials Costs.*
 - 8. *Penalties and damages paid etc. excluded from Packing Materials Costs.*
- 8.2 *Any change in the cost accounting principles and methods applied for the measurement and assignment of the Packing Materials Costs during the period covered by the cost statement which has a material effect on the Packing Materials Cost shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*
- 8.3 ***Disclosures shall be made only where material, significant and quantifiable.***
- 8.4 *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*



CAS-10

COST ACCOUNTING STANDARD ON DIRECT EXPENSES

The following is the COST ACCOUNTING STANDARD – 10 (CAS-10) issued by the Council of The Institute of Cost Accountants of India on “DIRECT EXPENSES”, for comments. In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material which has been set in normal type.

1. Introduction

1.1 This standard deals with the principles and methods of determining the Direct Expenses.

1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of Direct Expenses, for determination of the cost of product or service, and the presentation and disclosure in cost statements.***

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Direct Expenses with reasonable accuracy.

3. Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of Direct Expenses including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/ or due to some abnormal situation of the production or operation (Adapted from CAS 1 paragraph 6.5.19).***

4.2 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.3 ***Direct Employee Cost: Employee cost, which can be directly attributed to a cost object in an economically feasible way (Adapted from CAS 1 paragraph 6.2.4 (Direct labour cost)).***

4.4 ***Direct Expenses: Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost (Adapted from CAS 1 paragraph 6.2.6).***

Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.

4.5 ***Direct Material Cost: The cost of material which can be attributed to a cost object in an economically feasible way (Adapted from CAS 1-6.2.3).***

4.6 ***Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose.***

4.7 ***Interest and Finance charges: Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.***

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology). The terms Finance costs and Borrowing costs are used interchangeably.

- 4.8 **Overheads: Overheads comprise costs of indirect materials, indirect employees and indirect expenses.**
- 4.9 **Standard Cost: A predetermined cost of a product or service based on technical specifications and efficient operating conditions.**

Standard costs are used as scale of reference to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

5. Principles of Measurement:

- 5.1 **Identification of Direct Expenses shall be based on traceability in an economically feasible manner.**
- 5.2.1 **Direct expenses incurred for the use of bought out resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited.**
- 5.2.2 **Direct expenses other than those referred to in paragraph 5.2.1 shall be determined on the basis of amount incurred in connection therewith.**

Examples: in case of dies and tools produced internally, the cost of such dies and tools will include direct material cost, direct employee cost, direct expenses, factory overheads including share of administrative overheads relating to production comprising factory management and administration.

In the case of research and development cost, the amount traceable to the cost object for development and improvement of the process for the existing product shall be included in Direct Expenses.

- 5.2.3 **Direct Expenses paid or incurred in lump-sum or which are in the nature of 'one – time' payment, shall be amortised on the basis of the estimated output or benefit to be derived from such direct expenses.**

Examples: Royalty or Technical know-how fees, or drawing designing fees, are paid for which the benefit is ensued in the future period. In such case, the production / service volumes shall be estimated for the effective period and based on volume achieved during the Cost Accounting period, the charge for amortisation be determined.

- 5.3 **If an item of Direct Expenses does not meet the test of materiality, it can be treated as part of overheads.**
- 5.4 **Finance costs incurred in connection with the self generated or procured resources shall not form part of Direct Expenses.**
- 5.5 **Direct Expenses shall not include imputed costs. In case of goods produced for captive consumption, treatment of imputed cost shall be in accordance with Cost Accounting Standard – 4 (CAS-4).**
- 5.6 **Where direct expenses are accounted at standard cost, variances due to normal reasons shall be treated as part of the Direct Expenses. Variances due to abnormal reasons shall not form part of the Direct Expenses.**
- 5.7 **Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to any Direct Expenses shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.**
- 5.8 **Any abnormal portion of the direct expenses where it is material and quantifiable shall not form part of the Direct Expenses.**
- 5.9 **Penalties, damages paid to statutory authorities or other third parties shall not form part of the Direct Expenses.**
- 5.10 **Credits/ recoveries relating to the Direct Expenses, material and quantifiable, shall be deducted to arrive at the net Direct Expenses.**
- 5.11 **Any change in the cost accounting principles applied for the measurement of the Direct Expenses should be made only if, it is required by law or for compliance with the requirements of a cost accounting standard, or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.**



6. Assignment of costs

6.1 Direct Expenses that are directly traceable to the cost object shall be assigned to that cost object.

7. Presentation

7.1 Direct Expenses, if material, shall be presented as a separate cost head with suitable classification. e.g.

- Subcontract charges
- Royalty on production

8. Disclosures

8.1 The cost statements shall disclose the following:

- 1. The basis of distribution of Direct Expenses to the cost objects/ cost units.**
- 2. Quantity and rates of items of Direct Expenses, as applicable.**
- 3. Where Direct Expenses are accounted at standard cost, the price and usage variances.**
- 4. Direct expenses representing procurement of resources and expenses incurred in connection with resources generated.**
- 5. Direct Expenses paid/ payable to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).**
- 6. Direct Expenses incurred in foreign exchange.**
- 7. Any Subsidy/Grant/Incentive and any such payment reduced from Direct Expenses.**
- 8. Credits/recoveries relating to the Direct Expenses.**
- 9. Any abnormal portion of the Direct Expenses.**
- 10. Penalties and damages excluded from the Direct Expenses**

8.2 Disclosures shall be made only where material, significant and quantifiable.

8.3 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.

8.4 Any change in the cost accounting principles and methods applied for the measurement and assignment of the Direct Expenses during the period covered by the cost statement which has a material effect on the Direct Expenses. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

CAS - 11

COST ACCOUNTING STANDARD ON ADMINISTRATIVE OVERHEADS

The following is the COST ACCOUNTING STANDARD – (CAS-11) issued by the Council of The Institute of Cost Accountants of India on “ADMINISTRATIVE OVERHEADS”. In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material which has been set in normal type.

1. Introduction

1.1 This standard deals with the principles and methods of determining the administrative overheads.

1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of administrative overheads, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.***

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the administrative overheads with reasonable accuracy.

3. Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of administrative overheads including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/or due to some abnormal situation of the production or operation (Adapted from CAS 1 Para 6.5.19).***

4.2 ***Absorption of overheads: Assigning of overheads to cost objects by means of appropriate absorption rate.***

Overhead Absorption Rate = Overheads of the Cost object / Quantum of base.

4.3 ***Administrative Overheads: Cost of all activities relating to general management and administration of an entity.***

Administrative overheads shall exclude production overheads (Paragraph reference 4.13 CAS -9), marketing overheads (Paragraph reference 4.11 CAS -7) and finance cost. Production overheads includes administration cost relating to production, factory, works or manufacturing.

4.4 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.5 ***Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose.***

4.6 ***Interest and Finance charges: Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.***

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology). The terms Finance costs and Borrowing costs are used interchangeably.



4.7 Normal capacity: *Normal Capacity is the production achieved or achievable on an average over a number of periods or seasons under normal circumstances taking into account the loss of capacity resulting from planned maintenance (Adapted from CAS 2 Para 4.4).*

4.8 Overheads: *Overheads comprise costs of indirect materials, indirect employees and indirect expenses.*

5. Principles of Measurement

5.1 Administrative overheads shall be the aggregate of cost of resources consumed in activities relating to general management and administration of an organisation.

It usually represents the cost of shared services, cost of infrastructure and general management costs. Administrative overheads comprise items such as employee costs, utilities, office supplies, legal expenses and outside services. The principles of measurement of Material Cost, Employee Costs, Utilities, Repairs and Maintenance and Depreciation found in the respective standards will apply to these elements included in administrative overheads.

5.2 In case of leased assets, if the lease is an operating lease, the entire rentals shall be included in the administrative overheads. If the lease is a financial lease, the finance cost portion shall be segregated and treated as part of finance costs.

5.3 The cost of software (developed in house, purchased, licensed or customized), including up-gradation cost shall be amortised over its estimated useful life.

When hardware requires up-gradation along with software up-gradation, it is recommended that compatible estimated lives be used for the two sets of cost.

5.4 The cost of administrative services procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited.

5.5 Any Subsidy/Grant/Incentive or any amount of similar nature received/receivable with respect to any Administrative overheads shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.

5.6 Administrative overheads shall not include any abnormal administrative cost.

Example: Expense incurred in a situation of natural calamity.

5.7 Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the administrative overheads.

5.8 Credits/ recoveries relating to the administrative overheads including those rendered without any consideration, material and quantifiable, shall be deducted to arrive at the net administrative overheads.

5.9 Any change in the cost accounting principles applied for the measurement of the administrative overheads should be made only if it is required by law or for compliance with the requirements of a cost accounting standard or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.

6. Assignment of Cost

6.1 While assigning administrative overheads, traceability to a cost object in an economically feasible manner shall be the guiding principle.

6.2 Assignment of administrative overheads to the cost objects shall be based on either of the following two principles;

- (i) Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost.**
- (ii) Benefits received – overheads are to be apportioned to the various cost objects in proportion to the benefits received by them (Adapted from of CAS 3 Para 5.1).**

The costs of shared services should be assigned to user activities on the basis of actual usage.

Where the resources by way of infrastructure are shared the cost should be assigned on a readiness to serve basis.

General management costs should be assigned on rational basis.

For example: Number of employees, turnover, investment size etc.

7. Presentation

7.1 Administrative overheads shall be presented as a separate cost head in the cost statement.

7.2 Element wise details of the administrative overheads based on materiality shall be presented.

8. Disclosures

8.1 The cost statements shall disclose the following:

- **The basis of assignment of administrative overheads to the cost objects.**
- **Any imputed cost included as a part of administrative overheads.**
- **Administrative overheads incurred in foreign exchange.**
- **Cost of administrative activities received from or supplied to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).**
- **Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from administrative overheads.**
- **Credits / recoveries relating to the administrative overheads.**
- **Any abnormal portion of the administrative overheads.**
- **Penalties and damages excluded from the administrative overheads.**

8.2 Disclosures shall be made only where material, significant and quantifiable.

8.3 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.

8.4 Any change in the cost accounting principles and methods applied for the measurement and assignment of the administrative overheads during the period covered by the cost statement which has a material effect on the administrative overheads shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.



CAS – 12

COST ACCOUNTING STANDARD ON REPAIRS AND MAINTENANCE COST

The following is the COST ACCOUNTING STANDARD – 12 (CAS - 12) issued by the Council of The Institute of Cost Accountants of India on “REPAIRS AND MAINTENANCE COST”. In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material which has been set in normal type.

1. Introduction

1.1 This standard deals with the principles and methods of determining the repairs and maintenance cost.

1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of repairs and maintenance cost, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.***

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the repairs and maintenance cost with reasonable accuracy.

3. Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of repairs and maintenance cost including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.2 ***Direct Expenses: Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost.***

Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.

4.3 ***Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose.***

4.4 ***Interest and Finance charges: Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.***

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology). The terms Finance costs and Borrowing costs are used interchangeably.

4.5 ***Normal capacity: Normal Capacity is the production achieved or achievable on an average over a number of periods or seasons under normal circumstances taking into account the loss of capacity resulting from planned maintenance (Adapted from CAS 2 paragraph 4.4).***

4.6 ***Production overheads: Indirect costs involved in the production of a product or in rendering service.***

The terms Production Overheads, Factory Overheads, Works overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

Production overheads shall include administration cost relating to production, factory, works or manufacturing.

4.7 Repairs and maintenance cost: Cost of all activities which have the objective of maintaining or restoring an asset in or to a state in which it can perform its required function at intended capacity and efficiency.

Repairs and Maintenance activities for the purpose of this standard include routine or preventive maintenance, planned (predictive or corrective) maintenance and breakdown maintenance.

The repair or overhaul of an asset which results in restoration of the asset to intended condition would also be a part of Repairs and Maintenance activity.

Major overhaul is a periodic (generally more than one year) repair work carried out to substantially restore the asset to intended working condition.

4.8 Standard Cost: A predetermined cost of a product or service based on technical specifications and efficient operating conditions.

Standard costs are used as scale of reference to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

5. Principles of Measurement:

5.1 Repairs and maintenance cost shall be the aggregate of direct and indirect cost relating to repairs and maintenance activity.

Direct cost includes the cost of materials, consumable stores, spares, manpower, equipment usage, utilities and other identifiable resources consumed in such activity. Indirect cost includes the cost of resources common to various repairs and maintenance activities such as manpower, equipment usage and other costs allocable to such activities.

5.2 Cost of in-house repairs and maintenance activity shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity.

5.3 Cost of repairs and maintenance activity carried out by outside contractors inside the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs.

5.4 Cost of repairs and maintenance jobs carried out by contractor at its premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of other resources provided to the contractors.

5.5 Cost of repairs and maintenance jobs carried out by outside contractors shall include charges made by the contractor and cost of own materials, consumable stores, spares, manpower, equipment usage, utilities and other costs used in such jobs.

5.6.1 Each type of repairs and maintenance shall be treated as a distinct activity, if material and identifiable.

For example, routine or preventive maintenance, planned (predictive or corrective) maintenance and breakdown maintenance should be identified separately.

5.6.2 Cost of repairs and maintenance activity shall be measured for each major asset category separately.

5.7 Cost of spares replaced which do not enhance the future economic benefits from the existing asset beyond its previously assessed standard of performance shall be included under repairs and maintenance cost.

5.8 High value spare, when replaced by a new spare and is reconditioned, which is expected to result in future economic benefits, the same shall be taken into stock.

Such a spare shall be valued at an amount that measures its service potential in relation to a new spare which amount shall not exceed the cost of reconditioning the spare. The difference between the total of the cost of the new spare and the reconditioning cost and the value of the reconditioned spare should be treated as repairs and maintenance cost.



Example: The cost of new spare is ₹ 1 crore and the value of the existing spare after reconditioning is estimated at ₹ 20 lacs, the difference of ₹ 80 lacs should be treated as repairs and maintenance cost.

5.9 The cost of major overhaul shall be amortized on a rational basis.

5.10 Finance costs incurred in connection with the repairs and maintenance activities shall not form part of Repairs and maintenance costs.

5.11 Repairs and maintenance costs shall not include imputed costs.

5.12 Price variances related to repairs and maintenance, where standard costs are in use, shall be treated as part of repairs and maintenance cost. The portion of usage variances attributable to normal reasons shall be treated as part of repairs and maintenance cost. Usage variances attributable to abnormal reasons shall be excluded from repairs and maintenance cost.

5.13 Subsidy / Grant / Incentive or amount of similar nature received / receivable with respect to repairs and maintenance activity, if any, shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.

5.14 Any repairs and maintenance cost resulting from some abnormal circumstances, if material and quantifiable, shall not form part of the repairs and maintenance cost.

Example: Major fire, explosions, flood and similar events are abnormal circumstances referred above.

5.15 Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the repairs and maintenance cost.

Example: A penalty imposed by a regulatory authority for wrongful construction or damages paid to third party for the loss caused due to improper working of property, plant & equipment, should not be included in repairs and maintenance cost.

5.16 Credits/ recoveries relating to the repairs and maintenance activity, material and quantifiable, shall be deducted to arrive at the net repairs and maintenance cost.

5.17 Any change in the cost accounting principles applied for the measurement of the repairs and maintenance cost should be made only if, it is required by law or for compliance with the requirements of a cost accounting standard, or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.

6. Assignment of costs

6.1 Repairs and maintenance costs shall be traced to a cost object to the extent economically feasible.

6.2 Where the repairs and maintenance cost is not directly traceable to cost object, it shall be assigned based on either of the following two principles;

(i) Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost.

(ii) Benefits received – overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.

6.3 If the repairs and maintenance cost (including the share of the cost of reciprocal exchange of services) is shared by several cost objects, the related cost shall be measured as an aggregate and distributed among the cost objects as per principles laid down in Cost Accounting Standard – 3.

7. Presentation

7.1 Repairs and maintenance cost, if material, shall be presented in the cost statement as a separate item of cost.

7.2 Asset category wise details of repairs and maintenance cost, if material, shall be presented separately.

7.3 Activity wise details of repairs and maintenance cost, if material, shall be presented separately.

8. Disclosures

8.1 The cost statements shall disclose the following:

- 1. The basis of distribution of repairs and maintenance cost to the cost objects/ cost units.**
- 2. Where standard cost is applied in repairs and maintenance cost, the price and usage variances.**
- 3. Repairs and maintenance cost of Jobs done in-house and outsourced separately.**
- 4. Cost of major overhauls, asset category wise and the basis of amortisation.**
- 5. Repairs and maintenance cost paid/ payable to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).**
- 6. Repairs and maintenance cost incurred in foreign exchange.**
- 7. Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from repairs and maintenance cost.**
- 8. Any credits / recoveries relating to the repairs and maintenance cost.**
- 9. Any abnormal portion of the repairs and maintenance cost.**
- 10. Penalties and damages excluded from the repairs and maintenance cost.**

8.2 Disclosures shall be made only where material, significant and quantifiable.

8.3 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.

8.4 Any change in the cost accounting principles and methods applied for the measurement and assignment of the repairs and maintenance cost during the period covered by the cost statement which has a material effect on the repairs and maintenance cost shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.



CAS – 13

COST ACCOUNTING STANDARD ON COST OF SERVICE COST CENTRE

The following is the COST ACCOUNTING STANDARD – 13 (CAS - 13) issued by the Council of The Institute of Cost Accountants of India on “Cost of Service Cost Centre”. In this Standard, the standard portions have been set in **bold italic** type. These are to be read in the context of the background material which has been set in normal type.

1. Introduction

1.1 This standard deals with the principles and methods of determining the cost of Service Cost Centre.

1.2 This standard covers the Service Cost Centre as defined in paragraph 4.11 of this standard. It excludes Utilities and Repairs & Maintenance Services dealt with in CAS-8 and CAS-12 respectively.

1.3 ***This standard deals with the principles and methods of classification, measurement and assignment of Cost of Service Cost Centre, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.***

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Cost of Service Cost Centre with reasonable accuracy.

3. Scope

This standard should be applied to the preparation and presentation of cost statements, which require classification, measurement and assignment of Cost of Service Cost Centre, including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/ or due to some abnormal situation of the production or operation (Adapted from CAS 1 paragraph 6.5.19).***

4.2 ***Administrative Overheads: Cost of all activities relating to general management and administration of an entity.***

Administrative overheads shall exclude production overheads (Paragraph reference 4.13 CAS -9), marketing overheads (Paragraph reference 4.11 CAS -7) and finance cost. Production overheads includes administration cost relating to production, factory, works or manufacturing.

4.3 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.4 ***Distribution Overheads: Distribution overheads, also known as distribution costs, are the costs incurred in handling a product or service from the time it is ready for despatch or delivery until it reaches the ultimate consumer including the units receiving the product or service in an inter-unit transfer.***

The cost of any non manufacturing operations such as packing, repacking, labelling, etc. at an intermediate storage location will be part of distribution cost.

4.5 ***Imputed Cost: Notional cost, not involving cash outlay, computed for any purpose.***

4.6 ***Interest and Finance charges: Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.***

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology). The terms Finance costs and Borrowing costs are used interchangeably.

4.7 Marketing overheads: Marketing overheads comprise of selling overheads and distribution overheads.

4.8 Normal capacity: Normal Capacity is the production achieved or achievable on an average over a number of periods or seasons under normal circumstances taking into account the loss of capacity resulting from planned maintenance (Adapted from CAS 2 paragraph 4.4).

4.9 Production Overheads: Indirect costs involved in the production of a product or in rendering service.

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

4.10 Selling Overheads: Selling overheads are the expenses related to sale of products or services and include all indirect expenses incurred in selling the products or services.

4.11 Standard Cost: A predetermined cost of a product or service based on technical specifications and efficient operating conditions.

Standard costs are used as scale of reference to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

4.12 Stand-by service: Any facility created as backup against any failure of the main source of service.

4.13 Support-Service Cost Centre: The cost centre which primarily provides auxiliary services across the entity.

The cost centre which provides services to Production, Operation or other Service Cost Centre but not directly engaged in manufacturing process or operation is a service cost centre. A service cost centre renders services to other cost centres / other units and in some cases to outside parties.

Examples of service cost centres are engineering, workshop, research & development, quality control, quality assurance, designing, laboratory, welfare services, safety, transport, Component, Tool stores, Pollution Control, Computer Cell, dispensary, school, crèche, township, Security etc.

Administrative Overheads include cost of administrative Service Cost Centre.

5. Principles of Measurement

5.1 Each identifiable service cost centre shall be treated as a distinct cost object for measurement of the cost of services subject to the principle of materiality.

5.2.1 Cost of service cost centre shall be the aggregate of direct and indirect cost attributable to services being rendered by such cost centre.

5.2.2 Cost of in-house services shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such service.

Cost of other resources includes related overheads.

5.2.3 Cost of services rendered by contractors within the facilities of the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources provided to the contractors for such services.

5.2.4 Cost of services rendered by contractors at their premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of resources provided to the contractors.



- 5.2.5 **Cost of services for the purpose of inter unit transfers shall also include distribution costs incurred for such transfers.**
- 5.2.6 **Cost of services for the purpose of inter-company transfers shall also include distribution cost incurred for such transfers and administrative overheads.**
- 5.2.7 **Cost of services rendered to outside parties shall also include distribution cost incurred for such transfers, administrative overheads and marketing overheads.**
- 5.3 **Finance costs incurred in connection with the Service Cost Centre shall not form part of the cost of Service Cost Centre.**
- 5.4 **The cost of service cost centre shall not include imputed costs.**
- 5.5 **Where the cost of service cost centre is accounted at standard cost, the price and usage variances related to the services cost Centre shall be treated as part of cost of services. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.**
- 5.6 **Any Subsidy / Grant / Incentive or any such payment received / receivable with respect to any service cost centre shall be reduced for ascertainment of the cost to which such amounts are related.**
- 5.7 **The cost of production and distribution of the service shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost (Adapted from Paragraph 5.7 of CAS 3). Cost of a Stand-by service shall include the committed costs of maintaining such a facility for the service.**
- 5.8 **Any abnormal cost where it is material and quantifiable shall not form part of the cost of the service cost centre.**
- 5.9 **Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of the service cost centre.**
- 5.10 **Credits/recoveries relating to the service cost centre including charges for services rendered to outside parties, material and quantifiable, shall be reduced from the total cost of that service cost centre.**
- 5.11 **Any change in the cost accounting principles applied for the measurement of the cost of Service Cost Centre shall be made, only if it is required by law or for compliance with the requirements of a cost accounting standard, or a change would result in a more appropriate preparation or presentation of cost statements of an enterprise.**
6. **Assignment of Cost**
- 6.1 **While assigning cost of services, traceability to a cost object in an economically feasible manner shall be the guiding principle.**
- 6.2 **Where the cost of services rendered by a service cost centre is not directly traceable to a cost object, it shall be assigned on the most appropriate basis.**
- 6.3 **The most appropriate basis of distribution of cost of a service cost centre to the cost centres consuming services is to be derived from logical parameters which could be related to the usage of the service rendered. The parameter shall be equitable, reasonable and consistent.**
7. **Presentation**
- 7.1 **Cost of service cost centre shall be presented as a separate cost head for each type of service in the cost statement, if material.**

8. Disclosures

8.1 The cost statements shall disclose the following:

- 1. The basis of distribution of cost of each service cost centre to the consuming centres.**
- 2. The cost of purchase, production, distribution, marketing and price of services with reference to sales to outside parties**
- 3. Where the cost of service cost centre is disclosed at standard cost, the price and usage variances**
- 4. The cost of services received from / rendered to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).**
- 5. Cost of service cost centre incurred in foreign exchange.**
- 6. Any Subsidy/Grant/Incentive and any such payment reduced from cost of Service Cost Centre.**
- 7. Credits/ recoveries relating to the cost of Service Cost Centre**
- 8. Any abnormal cost excluded from cost of Service Cost Centre**
- 9. Penalties and damages paid excluded from cost of Service Cost Centre.**

8.2 Any change in the cost accounting principles and methods applied for the measurement and assignment of the cost of service cost centre during the period covered by the cost statement which has a material effect on the cost of service cost centre shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be disclosed.

8.3 Disclosures shall be made only where material and significant.

8.4 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule prominently.



CAS - 14

COST ACCOUNTING STANDARD ON POLLUTION CONTROL COST

The following is the Cost Accounting Standard - 14 (CAS - 14) issued by the Council of The Institute of Cost Accountants of India on "POLLUTION CONTROL COST". In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material, which has been set in normal type.

1. Introduction

This standard deals with principles and methods of determining the Pollution control costs.

This standard deals with the principles and methods of classification, measurement and assignment of pollution control costs, for determination of Cost of product or service, and the presentation and disclosure in cost statements.

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Pollution Control Costs with reasonable accuracy.

3. Scope

This standard should to be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Pollution Control Costs including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

- 4.1 ***Air pollutant: Air Pollutant means any solid, liquid or gaseous substance (including noise) present in the atmosphere in such concentration as may be or tend to be injurious to human beings or other living creatures or plants or property or environment (Section 2 (a) of The Air (Prevention and Control of Pollution) Act, 1981).***
- 4.2 ***Air Pollution: Air pollution means the presence in the atmosphere of any air pollutant (Section 2 (b) of The Air (Prevention and Control of Pollution) Act, 1981).***
- 4.3 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***
- 4.4 ***Direct Expenses: Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost (Adapted from Paragraph 4.4 of CAS - 10).***
- 4.5 ***Environment: Environment includes water, air and land and the inter-relationship which exists among and between water, air and land, and human beings, other living creatures, plants, micro-organism and property (Section 2 (a) of The Environment (Protection) Act, 1986).***
- 4.6 ***Environmental Pollutant: Environmental Pollutant means any solid, liquid or gaseous substance present in such concentration as may be, or tend to be, injurious to environment (Section 2 (b) of The Environment (Protection) Act, 1986).***
- 4.7 ***Environment Pollution: Environmental pollution means the presence in the environment of any environmental pollutant (Section 2 (c) of The Environment (Protection) Act, 1986).***

4.8 Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose.

4.9 Interest and Finance charges: Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology). The terms Finance costs and Borrowing costs are used interchangeably.

4.10 Normal capacity: Normal Capacity is the production achieved or achievable on an average over a number of periods or seasons under normal circumstances taking into account the loss of capacity resulting from planned maintenance (Adapted from CAS 2 paragraph 4.4).

4.11 Pollution Control: Pollution Control means the control of emissions and effluents into environment. It constitutes the use of materials, processes, or practices to reduce, minimize, or eliminate the creation of pollutants or wastes. It includes practices that reduce the use of toxic or hazardous materials, energy, water, and / or other resources.

4.12 Production overheads: Indirect costs involved in the production of a product or in rendering service.

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

Production overheads shall include administration cost relating to production, factory, works or manufacturing.

4.13 Soil Pollutant: Soil Pollutant is a substance which is the source of soil contamination.

4.14 Soil Pollution: Soil pollution means the presence of any soil pollutant(s) in the soil which is harmful to the living beings when it crosses its threshold concentration level.

4.15 Standard Cost: A predetermined cost of a product or service based on technical specifications and efficient operating conditions.

Standard costs are used as scale of reference to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

4.16 Water pollution: Water pollution means such contamination of water or such alteration of the physical, chemical or biological properties of water or such discharge of any sewage or trade effluent or of any other liquid, gaseous or solid substance into water (whether directly or indirectly) as may, or is likely to, create a nuisance or render such water harmful or injurious to public health or safety, or to domestic, commercial, industrial, agricultural or other legitimate uses, or to the life and health of animals or plants or of aquatic organisms (Section 2 (e) of The Water (Prevention and Control of Pollution) Act, 1974).

5. Principles of Measurement:

5.1 Pollution Control costs shall be the aggregate of direct and indirect cost relating to Pollution Control activity.

Direct cost includes the cost of materials, consumable stores, spares, manpower, equipment usage, utilities, resources for testing & certification and other identifiable resources consumed in activities such as waste processing, disposal, remediation and others.

Indirect cost includes the cost of resources common to various Pollution Control activities such as Pollution Control Registration and such like expenses.



5.2 **Costs of Pollution Control which are internal to the entity should be accounted for when incurred. They should be measured at the historical cost of resources consumed.**

5.3 **Future remediation or disposal costs which are expected to be incurred with reasonable certainty as part of Onerous Contract or Constructive Obligation, legally enforceable shall be estimated and accounted based on the quantum of pollution generated in each period and the associated cost of remediation or disposal in future.**

For example future disposal costs of solid waste generated during the current period should be estimated on, say, a per tonne basis.

5.4 **Contingent future remediation or disposal costs e.g. those likely to arise on account of future legislative changes on pollution control shall not be treated as cost until the incidence of such costs become reasonably certain and can be measured.**

External costs of pollution which are generally the costs imposed on external parties including social costs are difficult to estimate with reasonable accuracy and are excluded from general purpose cost statements.

Social costs of pollution are measured by economic models of cost measurement. The cost by way of compensation by the polluting entity either under future legislation or under social pressure cannot be quantified by traditional models of cost measurement. They are best kept out of general purpose cost statements.

5.5 **Cost of in-house Pollution Control activity shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity.**

5.6 **Cost of Pollution Control activity carried out by outside contractors inside the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs.**

5.7 **Cost of Pollution Control jobs carried out by contractor at its premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of other resources provided to the contractors.**

5.8 **Cost of Pollution Control jobs carried out by outside contractors shall include charges made by the contractor and cost of own materials, consumable stores, spares, manpower, equipment usage, utilities and other costs used in such jobs.**

5.9 **Each type of Pollution Control e.g. water, air, soil pollution shall be treated as a distinct activity, if material and identifiable.**

5.10 **Finance costs incurred in connection with the Pollution Control activities shall not form part of Pollution Control costs.**

5.11 **Pollution Control costs shall not include imputed costs.**

5.12 **Price variances related to Pollution Control, where standard costs are in use, shall be treated as part of Pollution Control cost. The portion of usage variances attributable to normal reasons shall be treated as part of Pollution Control cost. Usage variances attributable to abnormal reasons shall be excluded from Pollution Control cost.**

5.13 **Subsidy / Grant / Incentive or amount of similar nature received / receivable with respect to Pollution Control activity, if any, shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.**

5.14 **Any Pollution Control cost resulting from abnormal circumstances, if material and quantifiable, shall not form part of the Pollution Control cost.**

- 5.15 **Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the Pollution Control cost.**
- 5.16 **Credits / recoveries relating to the Pollution Control activity, material and quantifiable, shall be deducted to arrive at the net Pollution Control cost.**
- 5.17 **Research and development cost to develop new process, new products or use of new materials to avoid or mitigate pollution shall be treated as research and development costs and not included under pollution control costs. Development costs incurred for commercial development of such product, process or material shall be included in pollution control costs.**
- 5.18 **Any change in the cost accounting principles applied for the measurement of the Pollution Control cost should be made only if, it is required by law or for compliance with the requirements of a cost accounting standard, or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.**

6. Assignment of costs

- 6.1 **Pollution Control costs shall be traced to a cost object to the extent economically feasible.**

Direct costs of pollution control such as treatment and disposal of waste shall be assigned directly to the product, where traceable economically.

Where these costs are not directly traceable to the product but are traceable to a process which causes pollution, the costs shall be assigned to the products passing through the process based on the quantity of the pollutant generated by the product.

- 6.2 **Where the Pollution Control cost is not directly traceable to cost object, it shall be treated as overhead and assigned based on either of the following two principles;**
 - (i) **Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost.**
 - (ii) **Benefits received – overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.**

Typical of such costs are costs such as administration costs relating to pollution control activities, costs of certification such as ISO 14000 and registration fees payable to pollution control authorities

- 6.3 **If the Pollution Control cost (including the share of the cost of reciprocal exchange of services) is shared by several cost objects, the related cost shall be measured as an aggregate and distributed among the cost objects as per principles laid down in Cost Accounting Standard – 3.**

7. Presentation

- 7.1 **Pollution Control cost, if material, shall be presented in the cost statement as a separate item of cost.**

- 7.2 **Pollution control costs shall be presented duly classified as follows:**

- (a) **Direct and Indirect cost**
- (b) **Internal and External costs**
- (c) **Current and future costs**
- (d) **Domain area e.g. water, air and soil.**

- 7.3 **Activity wise details of Pollution Control cost, if material, shall be presented separately.**



8. Disclosures

8.1 The cost statements shall disclose the following:

- 1. The basis of distribution of Pollution Control cost to the cost objects/ cost units.**
- 2. Where standard cost is applied in Pollution Control cost, the price and usage variances.**
- 3. Pollution Control cost of Jobs done in-house and outsourced separately.**
- 4. Pollution Control cost paid/ payable to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement)**
- 5. Pollution Control cost incurred in foreign exchange.**
- 6. Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from Pollution Control cost.**
- 7. Any credits / recoveries relating to the Pollution Control cost.**
- 8. Any abnormal portion of the Pollution Control cost.**
- 9. Penalties and damages excluded from the Pollution Control cost.**
- 10. Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement**

8.2 Disclosures shall be made only where material, significant and quantifiable.

8.3 Cost incurred on pollution control relating to prior periods and taken to reconciliation directly shall be disclosed separately.

8.4 Where estimates are made of future costs to be incurred on pollution control, the basis of estimate shall be disclosed separately.

8.5 If a descriptive note dealing with the social cost of pollution caused by the entity and the control of such pollution is contained in the same document as the cost statement, the cost Statement shall carry a reference to such descriptive note.

8.6 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.

8.7 Any change in the cost accounting principles and methods applied for the measurement and assignment of the Pollution Control cost during the period covered by the cost statement which has a material effect on the Pollution Control cost shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

CAS - 15

COST ACCOUNTING STANDARD ON SELLING AND DISTRIBUTION OVERHEADS

The following is the COST ACCOUNTING STANDARD -15 (CAS-15) issued by the Council of The Institute of Cost Accountants of India on “**SELLING AND DISTRIBUTION OVERHEADS**”. In this standard, the standard portions have been set in **bold italic** type. These are to be read in the context of the background material which has been set in normal type.

1. Introduction

This standard deals with the principles and methods of determining the Selling and Distribution Overheads.

This standard deals with the principles and methods of classification, measurement and assignment of Selling and Distribution Overheads, for determination of the cost of sales of product or service, and the presentation and disclosure in cost statements.

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Selling and Distribution Overheads with reasonable accuracy.

3. Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of Selling and Distribution Overheads including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and / or due to some abnormal situation of the production or operation (CAS 3 (Revised 2011) Para 4.1).***

4.2 ***Absorption of overheads: Assigning of overheads to cost objects by means of appropriate absorption rate.***

Overhead Absorption Rate = Overheads of the Cost object / Quantum of base.

4.3 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.4 ***Distribution overheads: Distribution overheads, also known as distribution costs, are the costs incurred in handling a product or service from the time it is ready for despatch or delivery until it reaches the ultimate consumer including the units receiving the product or service in an inter-unit transfer.***

The cost of packing, repacking, labelling, etc. at an intermediate storage location will be part of distribution cost.

For Example:

1. Packing, repacking / labelling at an intermediate storage location
2. Transportation cost
3. Cost of warehousing (cover depots, godowns, storage yards, stock yards etc.)

Note:

In case of machinery involving technical help in installation, such expenses for installation are part of cost of production and not considered as cost of Selling and Distribution Overheads.



- 4.5 **Imputed Costs:** Notional cost, not involving cash outlay, computed for any purpose.
- 4.6 **Indirect expenses:** Expenses which cannot be directly attributed to a particular cost object.
- 4.7 **Marketing Overheads:** Marketing overheads comprise of selling overheads and distribution overheads.
- 4.8 **Overheads:** Overheads comprise costs of indirect materials, indirect employees and indirect expenses.
- 4.9 **Selling Overheads:** Selling overheads are the expenses related to sale of products or services and include all indirect expenses incurred in selling the products or services.

For Example:

1. Salaries of sales personnel
2. Travelling expenses of sales personnel
3. Commission to sales agents
4. Sales and brand promotion expenses including advertisement, publicity, sponsorships, endorsements and similar other expenses.
5. Receivable Collection costs
6. After sales service costs
7. Warranty costs

5. Principles of Measurement

- 5.1 **Selling and Distribution Overheads shall be the aggregate of the cost of resources consumed in the selling and distribution activities of the entity. The cost of resources procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), taxes and duties refundable or to be credited by the Tax Authorities.**

Post sales costs such as warranty cost, product liability cost, after sales service shall be estimated on a reasonable basis.

- 5.2 **Selling and Distribution Overheads, the benefits of which are expected to be derived over a long period, shall be amortised on a rational basis.**
- 5.3 **Selling and distribution overheads shall not include imputed cost.**
- 5.4 **Cost of after Sales Service provided in terms of sale agreement for a class of transactions, shall be determined on rational and scientific basis, net of any recovery on the service.**
- 5.5 **Any Subsidy / Grant / Incentive or any such payment received / receivable with respect to any Selling and Distribution Overheads shall be reduced from the cost of the sales of the cost object.**
- 5.6 **Any abnormal cost relating to selling and distribution activity shall be excluded from the Selling and Distribution Overheads.**
- 5.7 **Any demurrage or detention charges, or penalty levied by transportation or other authorities in respect of distribution activity shall not form part of the Selling and Distribution Overhead.**
- 5.8 **Penalties and damages paid to statutory authorities or other third parties shall not form part of the Selling and Distribution Overheads.**
- 5.9 **Credits / recoveries relating to the Selling and Distribution Overheads including those rendered without any consideration, material and quantifiable, shall be deducted to arrive at the net Selling and Distribution Overheads.**
- 5.10 **Any change in the cost accounting principles applied for the measurement of the Selling and Distribution Overheads shall be made only if it is required by law or for compliance with the requirements of a cost accounting standard or a change would result in a more appropriate preparation or presentation of cost statements of an entity.**

6. Assignment of Cost

- 6.1 *Selling and Distribution Overheads directly traceable shall be assigned to the relevant product sold or services rendered.*
- 6.2 *Transportation cost relating to distribution shall be assigned as per CAS – 5, where relevant and applicable.*
- 6.3 *Assignment of Selling and Distribution Overheads to the cost objects shall be based on either of the following two principles:*
 - (i) *Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost.*
 - (ii) *Benefits received – overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.*

7. Presentation

- 7.1 *Selling and Distribution overheads shall be presented as a separate cost head in the cost statement.*

A reporting entity may use the term marketing Overheads in place of Selling and Distribution overheads.
- 7.2 *Element wise details of the Selling and Distribution overheads shall be presented, if material.*

8. Disclosures

- 8.1 *The cost statements shall disclose the following:*
 - 1. *The basis of distribution of Selling and Distribution Overheads to the cost objects.*
 - 2. *Selling and Distribution Overheads incurred in foreign exchange.*
 - 3. *Cost of Selling and Distribution services rendered to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).*
 - 4. *Any Subsidy / Grant / Incentive and any such payment reduced from Selling and Distribution Overheads.*
 - 5. *Credits / recoveries relating to the Selling and Distribution Overheads.*
 - 6. *Penalties and damages excluded from the Selling and Distribution Overheads.*
- 8.2 *Disclosures shall be made only where material and significant.*
- 8.3 *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*
- 8.4 *Any change in the cost accounting principles and methods applied for the measurement and assignment of the Selling and Distribution Overheads during the period covered by the cost statement which has a material effect on the Selling and Distribution Overheads shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*

9. Effective date:

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2013 for being applied for the preparation and certification of General Purpose Cost Accounting Statements.



CAS -16

COST ACCOUNTING STANDARD ON DEPRECIATION AND AMORTISATION

The following is the COST ACCOUNTING STANDARD – 16 (CAS – 16) issued by the Council of The Institute of Cost Accountants of India on “**DEPRECIATION AND AMORTISATION**”. In this Standard, the standard portions have been set in ***bold italic*** type. This standard should be read in the context of the background material which has been set in normal type.

1. Introduction

This standard deals with the principles and methods of measurement and assignment of Depreciation and Amortisation for determination of the cost of product or service, and the presentation and disclosure in cost statements.

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Depreciation and Amortisation with reasonable accuracy.

3. Scope

This standard shall be applied to cost statements which require measurement, assignment, presentation and disclosure of Depreciation and Amortisation, including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified:-

4.1 Amortisation: Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

It refers to expensing the acquisition cost minus the residual value of intangible assets such as Franchise, Patents and Trademarks or Copyrights in a systematic manner over their estimated useful economic life so as to reflect their consumption in the production of goods and services.

4.2 Asset: An Asset is a resource;

(a) controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.

An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise. In case of some assets which are acquired for safety or environmental reasons, the acquisition of such assets may not provide future economic benefits directly but may be necessary for an entity to obtain the future economic benefits from other assets. Such items also qualify for recognition as assets.

4.3 Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.

4.4 Current asset: An entity shall classify an asset as current when :

(a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;

(b) it holds the asset primarily for the purpose of trading;

(c) it expects to realise the asset within twelve months after the reporting period; or (d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

- 4.5 **Depreciation:** *Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.*
- 4.6 **Depreciable amount:** *The cost of an asset, or other amount substituted for cost in the financial statement, less its residual value.*
- 4.7 **Depreciable fixed and Intangible assets are assets which:**
- (i) *are expected to be used during more than one accounting period;*
 - (ii) *have a limited useful life; and*
 - (iii) *are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.*

Land is not a depreciable asset as it does not have a defined useful life.

- 4.8 **Residual (salvage) value:** *The estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the assets were already of the age and in the condition expected at the end of its useful life.*
- 4.9 **Useful life of asset:** *Useful life of asset is either:*
- (a) *the period over which a asset is expected to be available for use by an entity ; or*
 - (b) *the number of production or similar units expected to be obtained from use of the asset by the entity.*

5. Principles of Measurement

- 5.1 **Depreciation and Amortisation shall be measured based on the depreciable amount and the useful life.**
The residual value of an intangible asset shall be assumed to be zero unless:
- (a) *there is a commitment by a third party to purchase the asset at the end of its useful life; or*
 - (b) *there is an active market for the asset and:*
 - I. *residual value can be determined by reference to that market; and*
 - II. *it is probable that such a market will exist at the end of the asset's useful life.*
 - III. *The residual value of a fixed asset shall be considered as zero if the entity is unable to estimate the same with reasonable accuracy.*

The minimum amount of depreciation to be provided shall not be less than the amount calculated as per principles and methods as prescribed by any law or regulations applicable to the entity and followed by it.

- 5.2 **In case of regulated industry the amount of depreciation shall be the same as prescribed by the concerned regulator.**
- 5.3 **While estimating the useful life of a depreciable asset, consideration shall be given to the following factors:**
- (a) *Expected physical wear and tear;*
 - (b) *Obsolescence; and*
 - (c) *Legal or other limits on the use of the asset.*
- 5.4 **The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset.**

If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a re-acquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.

The useful life of an intangible asset, in any situation, shall not exceed 10 years from the date it is available for use.

5.5 Depreciation shall be considered from the time when a depreciable asset is first put into use.

An asset which is used only when the need arises but is always held ready for use. Example: fire extinguisher, stand by generator, safety equipment shall be considered to be an asset in use. Depreciable assets will be considered to be put into use when commercial production of goods and services commences.

Depreciation on an asset which is temporarily retired from production of goods and services shall be considered as abnormal cost for the period when the asset is not in use.

5.6 Depreciation of any addition or extension to an existing depreciable asset which becomes an integral part of that asset shall be based on the remaining useful life of that asset.

5.7 Depreciation of any addition or extension to an existing depreciable asset which retains a separate identity and is capable of being used after the expiry of the useful life of that asset shall be based on the estimated useful life of that addition or extension.

5.8 The impact of higher depreciation due to revaluation of assets shall not be assigned to cost object.

5.9 Impairment loss on assets shall be excluded from cost of production.

5.10 The method of depreciation used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

5.11 An entity can use any of the methods of depreciation to assign depreciable amount of an asset on a systematic basis over its useful life.

For example:

- (a) Straight-line method;
- (b) Diminishing balance method; and
- (c) Units of production method.

5.12 The method of amortisation of intangible asset shall reflect the pattern in which the economic benefits accrue to entity.

5.13 The methods and rates of depreciation applied shall be reviewed at least annually and, if there has been a change in the expected pattern of consumption or loss of future economic benefits, the method applied shall be changed to reflect the changed pattern.

5.14 Spares purchased specifically for a particular asset, or class of assets, and which would become redundant if that asset or class of asset was retired or use of that asset was discontinued, shall form part of that asset. The depreciable amount of such spares shall be allocated over the useful life of the asset.

5.15 Cost of small assets shall be written off in the period in which they were purchased as per the accounting policy of the entity.

5.16 Depreciation of an asset shall not be considered in case cumulative depreciation exceeds the original cost of the asset, net of residual value.

5.17 Where depreciation for an addition of an asset is measured on the basis of the number of days for which the asset was used for the preparation and presentation of financial statements, depreciation of the asset for assigning to cost of object shall be measured in relation to the period, the asset actually utilized.

6. Assignment of Costs

6.1 Depreciation shall be traced to the cost object to the extent economically feasible.

6.2 Where the depreciation is not directly traceable to cost object, it shall be assigned based on either of the following two principles:

- i. Cause and effect - cause is a process or operation or activity and effect is the incurrence of cost.**
- ii. Benefits received– depreciation is to be apportioned to the various cost objects in proportion to the benefits received by them.**

7. Presentation

Depreciation and Amortisation, if material, shall be presented in the cost statement as a separate item of cost.

8. Disclosures

8.1 The cost statement shall disclose the following:-

- 1. The basis of distribution of Depreciation and Amortisation to the cost objects.**
- 2. Any credits / recoveries relating to Depreciation and Amortisation.**
- 3. Additional Depreciation on account of revaluation of asset, which is not included in cost.**
- 4. Amount of depreciation that is not included in cost because of temporary retirement of assets from production of goods and services.**

8.2 Disclosure shall be made only where material, significant and quantifiable.

8.3 Disclosures shall be made in the body of the cost statement or as a foot note or in a separate schedule.

8.4 Any change in the cost accounting principles and methods applied for the measurement and assignment of Depreciation and Amortisation during the period covered by the cost statement which has a material effect on Depreciation and Amortisation shall be disclosed. Where the effect of such change is not ascertainable wholly or partly, the fact shall be indicated.

9. Effective date:

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2014 for being applied for the preparation and certification of General Purpose Cost Accounting Statements



CAS-17

COST ACCOUNTING STANDARD ON INTEREST AND FINANCING CHARGES

The following is the Cost Accounting Standard (CAS 17) issued by the Council of The Institute of Cost Accountants of India for determination of “**INTEREST AND FINANCING CHARGES**”. In this Standard, the standard portions have been set in **bold italic** type. These are to be read in the context of the background material which has been set in normal type.

1. Introduction

This standard deals with the principles and methods of classification, measurement and assignment of Interest and Financing Charges.

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles, methods of determining and assigning the Interest and Financing Charges with reasonable accuracy.

3. Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Interest and Financing Charges including those requiring attestation.

This standard does not deal with costs relating to risk management through derivatives.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 **Asset: An Asset is a resource;**

- (a) controlled by an entity as a result of past events; and***
- (b) from which future economic benefits are expected to flow to the entity.***

4.2 **Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.**

4.3 **Current asset: An entity shall classify an asset as current when :**

- (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;***
- (b) it holds the asset primarily for the purpose of trading;***
- (c) it expects to realise the asset within twelve months after the reporting period; or***
- (d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.***

4.4 **Current Liabilities: An entity shall classify a liability as current when :**

- (a) it expects to settle the liability in its normal operating cycle;***
- (b) it holds the liability primarily for the purpose of trading;***
- (c) the liability is due to be settled within twelve months after the reporting period ; or***
- (d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.***

4.5 Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose.

4.6 Intangible Asset: An intangible asset is an identifiable non-monetary asset without physical substance.

4.7 Interest and Finance charges: Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.

Examples are:

1. interest and commitment charges on bank borrowings, other short term and long term borrowings:
2. amortisation of discounts or premium related to borrowings:
3. amortisation of ancillary cost incurred in connection with the arrangements of borrowings:
4. Financing Charges in respect of finance leases and other similar arrangements: and
5. exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology).
6. Cash discount allowed to customers.

The terms Interest and financing charges, finance costs, and borrowing costs are used interchangeably.

4.8 Net current asset: Net current asset is the excess of current assets over current liabilities

Current Liabilities shall include *short term borrowings and that part of long term borrowings which are classified as current liabilities*

Short term borrowing is the borrowing which is repayable within one year from the date of disbursal as per Loan Agreement.

Long term borrowing is the borrowing which is repayable after one year from the date of disbursal as per Loan Agreement.

5. Principles of Measurement:

5.1 Interest and Financing Charges incurred shall be identified for :

(a) acquisition / construction/ production of qualifying assets including fixed assets; and

(b) Other finance costs for production of goods/ operations or services rendered which cannot be classified as qualifying assets.

5.2 Interest and Financing Charges directly attributable to the acquisition /construction/ production of a qualifying asset shall be included in the cost of the asset.

5.3 Interest and Financing Charges shall not include imputed costs.

5.4 Subsidy / Grant / Incentive or amount of similar nature received / receivable with respect to Interest and Financing Charges if any, shall be reduced to ascertain the net interest and financing charges.

5.5 Penal Interest for delayed payment, Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the Interest and Financing Charges.

In case the company delays the payment of Statutory dues beyond the stipulated date, interest paid for delayed payment shall not be treated as penal interest.

5.6 Interest paid for or received on investment shall not form part of the other financing charges for production of goods / operations or services rendered;



6. Assignment of costs

6.1 Assignment of Interest and Financing Charges to the cost objects shall be based on either of the following principles;

- I. Cause and effect- cause is the process or operation or activity and effect is the incurrence of cost.**
- II. Benefits received- Interest and Financing Charges are to be apportioned to the various cost objects in proportion to the benefits received by them.**

7. Presentation

Interest and Financing Charges shall be presented in the cost statement as a separate item of cost of sales.

8. Disclosures

8.1 The cost statements shall disclose the following:

- 1. The basis of distribution of Interest and Financing Charges to the cost objects/ cost units.**
- 2. Where predetermined cost is applied in Interest and Financing Charges, the rate and usage variances.**
- 3. Interest and Financing Charges paid/ payable to related parties.**
- 4. Interest and Financing Charges incurred in foreign exchange.**
- 5. Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced Interest and Financing Charges.**

8.2 Disclosures shall be made only where material, significant and quantifiable.

8.3 Interest and Financing Charges incurred relating to prior periods and taken to reconciliation directly shall be disclosed separately.

8.4 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.

8.5 Any change in the cost accounting principles and methods applied for the measurement and assignment of the Interest and Financing Charges during the period covered by the cost statement which has a material effect on the Interest and Financing Charges shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

9. Effective date:

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2014 for being applied for the preparation and certification of General Purpose Cost Accounting Statements.

CAS -18

COST ACCOUNTING STANDARD ON RESEARCH AND DEVELOPMENT COSTS

The following is the Cost Accounting Standard-18 (CAS-18) issued by the Council of The Institute of Cost Accountants of India for determination of "**RESEARCH AND DEVELOPMENT COSTS**". In this Standard, the standard portions have been set in ***bold italic*** type. This standard should be read in the context of the background material which has been set in normal type.

1. ***Introduction***

This standard deals with the principles and methods of determining the Research, and Development Costs and their classification, measurement and assignment for determination of the cost of product or service, and the presentation and disclosure in cost statements.

2. ***Objective***

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Research, and Development Costs with reasonable accuracy and presentation of the same.

3. ***Scope***

This standard should be applied to cost statements that require classification, measurement, assignment, presentation and disclosure of Research, and Development Costs including those requiring attestation.

4. ***Definitions***

The following terms are being used in this standard with the meaning specified.

4.1 Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/ or due to some abnormal situation of the production or operation (Adapted from CAS 1 paragraph 6.5.19).

4.2 Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.

4.3 Direct Employee Cost: Employee cost, which can be attributed to a Cost Object in an economically feasible way (Adapted from CAS 1 Para 6.2.4 (Direct labour cost)).

4.4 Direct Expenses: Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material or direct employee cost (Adapted from CAS 1 Para 6.2.6).

Examples of Direct Expenses are royalties charged on production, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.

4.5 Direct Materials: Materials, the cost of which can be attributed to a cost object in an economically feasible way (Adapted from CAS 1-6.2.3).

4.6 Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose

4.7 Indirect Employee Cost: The employee cost which cannot be directly attributed to a particular cost object.

4.8 Indirect Material Cost: Material cost that cannot be directly attributed to a particular cost object.

4.9 Indirect expenses: Expenses which cannot be directly attributed to a particular cost object.

4.10 Overheads: Overheads comprise costs of indirect materials, indirect employees and indirect expenses.

4.11 Research and Development:



4.11.1 Research: *Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding (Adapted AS 26).*

4.11.2 Development cost: *Development cost is the cost for application of research finding or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems, or services before the start of commercial production or use.*

4.11.3 Research Cost: *Research cost is the cost of original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.*

5. Principles of Measurement

5.1 Research, and Development Costs shall include all the costs that are directly traceable to research and/or development activities or that can be assigned to research and development activities strictly on the basis of (a) cause and effect or (b) benefits received. Such costs shall include the following elements:

1. The cost of materials and services consumed in Research, and Development activities.
2. Cost of bought out materials and hired services as per invoice or agreed price including duties and taxes directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited.
3. The salaries, wages and other related costs of personnel engaged in Research, and Development activities;
4. The depreciation of equipment and facilities, and other tangible assets, and amortisation of intangible assets to the extent that they are used for Research, and Development activities;
5. Overhead costs, other than general administrative costs, related to Research, and Development activities.
6. Costs incurred for carrying out Research, and Development activities by other entities and charged to the entity; and
7. Expenditure incurred in securing copyrights or licences
8. Expenditure incurred for developing computer software
9. Costs incurred for the design of tools, jigs, moulds and dies
10. Other costs that can be directly attributed to Research, and Development activities and can be identified with specific projects.

5.2 Subsidy / Grant / Incentive or amount of similar nature received / receivable with respect to Research, and Development Activity, if any, shall be reduced from the cost of such Research, and Development Activity.

5.3 Any abnormal cost where it is material and quantifiable shall not form part of the Research, and Development Cost.

5.4 Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the Research, and Development Cost.

5.5 The amortisation of an intangible asset arising from the development activity shall be treated as set out in the CAS 16 relating to Depreciation and Amortisation.

5.6 Research, and Development costs shall not include imputed costs.

5.7 Credits/recoveries relating to Research, and Development cost, if material and quantifiable, including from the sale of output produced from the Research and Development activity shall be deducted from the Research and Development cost.

6. Assignment of costs

6.1 Research, and Development costs attributable to a specific cost object shall be assigned to that cost object directly.

Research, development costs that are not attributable to a specific product or process shall not form part of the product cost.

6.2 Development cost which results in the creation of an intangible asset shall be amortised over its useful life

6.3 Assignment of Development Costs shall be based on the principle of "benefits received".

6.4 Research and Development Costs incurred for the development and improvement of an existing process or product shall be included in the cost of production.

In case the Research and Development activity related to the improvement of an existing process or product continues for more than one accounting period, the cost of the same shall be accumulated and amortised over the estimated period of use of the improved process or estimated period over which the improved product will be produced by the entity after the commencement of commercial production, as the case may be, if the improved process or product is distinctly different from the existing process or product and the product is marketed as a new product. The amount allocated to a particular period shall be included in the cost of production of that period. If the expenditure is only to improve the quality of the existing product or minor modifications in attributes, the principle shall not be applied.

6.5 Development costs attributable to a saleable service e.g providing technical know-how to outside parties shall be accumulated separately and treated as cost of providing the service.

7. Presentation

7.1 Research and Development costs relating to improvement of the process or products or services shall be presented as a separate item of cost in the cost statement under cost of production.

7.2 Research, and Development costs which are not related to improvement of the process, materials, devices, processes, systems, product or services shall be presented as a part of the reconciliation statement.

8. Disclosures

8.1 The cost statements shall disclose the following:

- 1. The basis of accumulation and assignment of Research and Development costs.**
- 2. The Research, and Development costs paid to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).**
- 3. Credit/recoveries from related parties**
- 4. Research, and Development cost incurred in foreign exchange.**
- 5. Any Subsidy/Grant/Incentive and any such payment reduced from Research, and Development cost.**
- 6. Credits/recoveries deducted from the Research, and Development cost.**
- 7. Any abnormal cost excluded from Research, and Development cost including cost of abandoned projects and research activities considered abnormal.**
- 8. Penalties and damages paid etc. excluded from Research, and Development cost.**

8.2 Any change in the cost accounting principles and methods applied for the measurement and assignment of the Research, and Development cost during the period covered by the cost statement that has a material effect on the Research, and Development cost shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

8.3 Disclosures shall be made only where material, significant and quantifiable.

8.4 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.



CAS-19

COST ACCOUNTING STANDARD ON JOINT COSTS

The following is the Cost Accounting Standard – 19 (CAS - 19) issued by the Council of The Institute of Cost Accountants of India for determination of “**JOINT COSTS**”. In this standard, the standard portions have been set in **bold Italic** type. This standard should be read in the context of the background material which has been set in normal type.

1. Introduction

The standard deals with the principles and methods of measurement and assignment of Joint Costs and the presentation and disclosure in cost statement.

2. Objective

The objective of this standard is to bring uniformity, consistency in the principles, methods of determining and assigning Joint Costs with reasonable accuracy.

3. Scope

The standard shall be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Joint Costs including those requiring attestation.

4. Definitions

The following terms are being used in this standard within the meaning specified.

- 4.1 ***By-Product: Product with relatively low value produced incidentally in the manufacturing of the product or service.***
- 4.2 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***
- 4.3 ***Imputed Cost: Notional cost, not involving cash outlay, computed for any purpose***
- 4.4 ***Joint Costs: Joint costs are the cost of common resources used to produce two or more products or services simultaneously.***
- 4.5 ***Joint product: Products or services that are produced simultaneously, by the same process, identifiable at the end of the process and recognised as main products or services having sufficient value.***
- 4.6 ***Scrap: Discarded material having no or insignificant value and which is usually either disposed off without further treatment (other than reclamation and handling) or reintroduced into the process in place of raw material.***
- 4.7 ***Split off point: The point in the production process at which joint products become separately identifiable.***
The terms split off point and separation point are used interchangeably.
- 4.8 ***Waste: Material lost during production or storage and discarded material which may or may not have any value.***

5. Principles of Measurement

- 5.1 ***The principles and methods for measuring Joint costs upto the split off point will be the same as stipulated in other cost accounting standards.***
- 5.2 ***Cost incurred after split-off point on product separately identifiable shall be measured for the resources consumed for each Joint/By-Product.***
- 5.3 ***Cost incurred after split-off point for further processing of joint product/By-Product shall be the aggregate of direct and indirect costs.***

- 5.4 **Cost of further processing of joint product/By-Product carried out by outside parties shall be determined at invoice or agreed price including duties and taxes, net of discounts (other than cash discount) taxes and duties refundable or to be credited and other expenditure directly attributable to such processing. This cost shall also include the cost of resources provided to outside parties.**
- 5.5 **In case the production process generates scrap or waste, realized or realizable value, net of disposal cost, of scrap and waste shall be deducted from the cost of Joint Product.**
- 5.6 **Any Subsidy / Grant / Incentive or any such payment received / receivable with respect to any joint product /By-Product shall be reduced for ascertainment of the cost to which such amounts are related.**
- 5.7 **Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of the joint product /By-Product.**

6. Assignment

- 6.1 **Joint cost incurred shall be assigned to joint products based on benefits received, which is measured using any of the following methods:**

- (a) Physical Units Method.
- (b) Net Realisable Value at split-off point.

Net realisable value for this purpose means the net selling price per unit multiplied by quantity (Quantity sold). Net realizable value is to be adjusted for the post- split off costs.

- (c) Technical estimates

- 6.2 **The value of By-Product shall be estimated using any of the following methods for adjusting joint costs :**

a. Net realizable value

Net realizable value for this purpose means the net selling price per unit multiplied by quantity (Quantity sold). Net realizable value is to be adjusted for the post- split off costs.

b. Technical Estimates

This method may be adopted where the By-Product is not saleable in the condition in which it emerges or comparative prices of similar products are not available.

7. Presentation

The Cost Statement shall present the element wise cost of individual products produced jointly and the value assigned to By-Products.

8. Disclosures

- 8.1 **The Cost statement shall disclose the basis of allocation of Joint costs to individual products and the value assigned to the By-Products**
- 8.2 **The Cost statement shall also disclose:**
- 8.3 **The disclosure should be made only where material, significant & quantifiable.**
- 8.4 **Disclosures shall be made in the body of Cost Statements or as a foot note or as a separate schedule.**
- 8.5 **Any change in the cost accounting principles and methods applied for the measurement and assignment of the Joint costs and the value assigned to by-product during the period covered by the cost statement which has a material effect on the Joint/ By-Products shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.**

9. Effective date:

This Cost Accounting Standard shall be effective from the period commencing on or after for being applied for the preparation and certification of General Purpose Cost Accounting Statements.



CAS-20

COST ACCOUNTING STANDARD ON ROYALTY AND TECHNICAL KNOW-HOW FEE

The following is Cost Accounting Standard- (CAS-20) issued by the council of The Institute of Cost Accountants of India for determination of "**ROYALTY AND TECHNICAL KNOW-HOW FEE**". In this Standard, the standard portions have been set in ***bold italic*** type. This standard should be read in the context of the background material which has been set in normal type.

1. Introduction

1.1 This standard deals with the principles and methods of determining the amount of Royalty and Technical Know-how Fee.

1.2 This standard deals with the principles and methods of classification, measurement and assignment of the amount of Royalty and Technical Know-how Fee, for determination of the cost of product or service, and their presentation and disclosure in cost statements.

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the amount of Royalty and Technical Know-how Fee with reasonable accuracy.

3. Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of the amount of Royalty and Technical Know-how Fee including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.

4.3 Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose.

4.4 Interest and Finance charges: Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology). The terms Finance costs and Borrowing costs are used interchangeably.

4.2 Royalty: Royalty is any consideration for the use of asset (tangible and/or intangible) to the owner.

Royalty is often expressed as a percentage of the revenues obtained by use of the owners asset (tangible and/or intangible); per unit of production or sales value. It may relate to use of: Non-renewable

resource (petroleum and mineral resources) ; Patents; Trade marks; Franchise rights; Copy rights; art-work, software and the like.

The terms Assets, tangible assets and intangible assets will have the same meaning as in the Accounting Standards notified by the Central Government under the Companies (Accounting Standards) Rules,2006.

- 4.5 Technical service fee: Technical service fee is any consideration payable to provider of technical or managerial services.**

5. Principles of Measurement:

- 5.1 Royalty and Technical Know-how Fee paid or incurred in lump-sum or which are in the nature of 'one – time' payment, shall be amortised on the basis of the estimated output or benefit to be derived from the related asset.**

Examples: Amortisation of the amount of Royalty or Technical Know-how fee paid for which the benefit is ensued in the current or future periods shall be determined based on the production / service volumes estimated for the period over which the asset is expected to benefit the entity .

- 5.2 Amount of the Royalty and Technical Know-how Fee shall not include finance costs and imputed costs.**
- 5.3 Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to amount of Royalty and Technical Know-how fee shall be reduced to measure the amount of royalty and technical know- how fee.**
- 5.4 Penalties, damages paid to statutory authorities or other third parties shall not form part of the amount of Royalty and Technical Know-how fee.**
- 5.5 Credits/ recoveries relating to the amount Royalty and Technical Know-how fee, material and quantifiable, shall be deducted to arrive at the net amount of Royalty and Technical Know-how fee.**
- 5.6 Any change in the cost accounting principles applied for the measurement of the amount of Royalty and Technical Know-how Fee should be made only if, it is required by law or for compliance with the requirements of a cost accounting standard, or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.**

6. Assignment of costs

- 6.1 Royalty and Technical Know-how fee that is directly traceable to a cost object shall be assigned to that cost object. In case such fee is not directly traceable to a cost object then it shall be assigned on any of the following basis:**

- a. Units produced**
- b. Units sold**
- c. Sales value**

- 6.2 The amount of Royalty fee paid for mining rights shall form part of the cost of material.**



6.3 The amount of Royalty and Technical Know-how fee shall be assigned on the nature/ purpose of such fee.

The amount of royalty and technical know-how fee related to product or process know how shall be treated as cost of production; if it is related to trademarks or brands shall be treated as cost of sales.

7. Presentation

7.1 The amount Royalty and Technical Know-how fee shall be presented as a separate cost head with suitable classification.

8. Disclosures

8.1 The cost statements shall disclose the following:

- 1. The basis of distribution of the amount Royalty and Technical Know-how fee to the cost objects/ cost units.**
- 2. Quantity and the related rate of items of the amount of Royalty and Technical Know-how fee, as applicable.**
- 3. Royalty and Technical Know-how fee paid/ payable to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement) .**
- 4. Royalty and Technical Know-how fee incurred in foreign exchange.**
- 5. Any Subsidy/Grant/Incentive and any such payment reduced from the amount of Royalty and Technical Know-how fee.**
- 6. Credits/recoveries relating to the amount of Royalty and Technical Know-how fee.**
- 7. Penalties and damages excluded from the amount of Royalty and Technical Know-how fee**

8.2 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.

8.3 Any change in the cost accounting principles and methods applied for the measurement and assignment of the amount Royalty and Technical Know-how fee during the period covered by the cost statement which has a material effect on the amount Royalty and Technical Know-how fee. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.

CAS-21

COST ACCOUNTING STANDARD ON QUALITY CONTROL

The following is the Cost Accounting Standard (CAS -21) issued by the Council of The Institute of Cost Accountants of India for determination of "QUALITY CONTROL ". In this standard, the standard portions have been set in **bold Italic** type. These are to be read in context of the background material which has been set in normal type.

1. Introduction

The standard deals with the principles and methods of measurement and assignment of Quality Control cost and the presentation and disclosure in cost statement.

2. Objective

The objective of this standard is to bring uniformity, consistency in the principles, methods of determining and assigning Quality Control cost with reasonable accuracy.

3. Scope

The standards shall be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Quality Control cost including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 ***Abnormal cost: An unusual or atypical cost whose occurrence is usually irregular and unexpected and/ or due to some abnormal situation of the production or operation (Adopted from CAS 1 paragraph 6.5.19).***

4.2 ***Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.***

4.3 ***Defectives: Materials, products or intermediate products that do not meet quality standards. This may include reworks or rejects.***

4.3.1 ***Rework: Defectives which can be brought up to the standards by putting in additional resources.***

Rework includes repairs, reconditioning and refurbishing.

4.3.2 ***Rejects: Defectives which cannot meet the quality standards even after putting in additional resources.***

Rejects may be disposed off as waste or sold for salvage value or recycled in the production process.

4.4 ***Imputed Costs: Notional cost, not involving cash outlay, computed for any purpose***

4.5 ***Interest and Finance charges: Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.***

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs (Adapted from CIMA Terminology). The terms Finance costs and Borrowing costs are used interchangeably.



4.6 Overheads: Overheads comprise costs of indirect materials, indirect employees and indirect expenses.

4.7 Quality: Quality is the conformance to requirements or specifications.

The quality of a product or service is fitness of that product or service for meeting its intended use as required by customer.

4.8 Quality control: A procedure or a set of procedures exclusively designed to ensure that the manufactured products or performed service adhere to a defined set of quality criterion or meets requirement of the client or the customer.

4.9 Quality Control cost: Cost of resources consumed towards quality control procedures

4.10 Scrap: Discarded material having no or insignificant value and which is usually either disposed off without further treatment (other than reclamation and handling) or reintroduced into the process in place of raw material.

4.11 Waste and spoilage:

4.11.1 Waste: Material lost during production or storage and discarded material which may or may not have any value.

4.11.2 Spoilage: Production that does not meet the quality requirements or specifications and cannot be rectified economically.

5. Principles of Measurement:

5.1 Quality Control cost incurred in-house shall be the aggregate of the cost of resources consumed in the Quality Control activities of the entity. The cost of resources procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), taxes and duties refundable or to be credited by the Tax Authorities.

Such cost shall include:

- Cost of conformance to quality: (a) prevention cost; and (b) appraisal cost.

5.2 Identification of Quality Control costs shall be based on traceability in an economically feasible manner.

5.3 Quality Control costs other than those referred to in paragraph 5.2 shall be determined on the basis of amount incurred in connection therewith.

5.4 Finance costs incurred in connection with the self generated or procured resources shall not form part of Quality Control cost.

5.5 Quality Control costs shall not include imputed costs.

5.6 Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to any Quality Control cost shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.

5.7 Any abnormal portion of the Quality Control cost where it is material and quantifiable shall not form part of the Cost of Quality Control.

5.8 Penalties, damages paid to statutory authorities or other third parties shall not form part of the Quality Control cost.

5.9 Any change in the cost accounting principles applied for the measurement of the Quality Control cost shall be made only if, it is required by law or for compliance with the requirements of a cost accounting standard, or a change would result in a more appropriate preparation or presentation of cost statements of an organisation.

6. Assignment of costs

6.1 Quality Control cost that is directly traceable to the cost object shall be assigned to that cost object.

6.2 Assignment of Quality Control cost to the cost objects shall be based on benefits received by them.

(i) Benefits received – Quality Control cost is to be apportioned to the various cost objects in proportion to the benefits received by them.

For example : On the basis of number of tests performed for a product.

7. Presentation

7.1 Quality Control cost, if material, shall be presented as a separate cost head with suitable classification.

8. Disclosures

8.1 The cost statements shall disclose the following:

8.1.1 The basis of distribution of Quality Control cost to the cost objects/ cost units.

8.1.2 Quantity and Cost of resources used for Quality Control cost as applicable.

8.1.3 Quality Control cost paid/ payable to related parties (Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement).

8.1.4 Quality Control cost incurred in foreign exchange.

8.1.5 Any abnormal portion of the Quality Control cost.

8.1.6 Penalties and damages excluded from the Quality Control cost

8.2 Disclosures shall be made only where material, significant and quantifiable.

8.3 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.

8.4 Any change in the cost accounting principles and methods applied for the measurement and assignment of the Quality Control cost during the period covered by the cost statement which has a material effect on the Quality Control cost shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.



CAS – 22

COST ACCOUNTING STANDARD ON MANUFACTURING COST

The following is the COST ACCOUNTING STANDARD – 22 (CAS - 22) issued by the Council of The Institute of Cost Accountants of India for determination of “**MANUFACTURING COST**”. In this Standard, the standard portions have been set in bold italic type. This standard should be read in the context of the background material which has been set in normal type.

1. Introduction

- 1.1 This standard deals with the principles and methods of determining the **Manufacturing Cost of excisable goods**.
- 1.2 *This standard deals with the principles and methods of classification, measurement and assignment for determination of the Manufacturing Cost of excisable goods and the presentation and disclosure in cost statements.*

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the Manufacturing Cost of excisable goods.

3. Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Manufacturing Cost of excisable goods.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 Abnormal and non-recurring cost: *An unusual or atypical cost whose occurrence is usually irregular and unexpected and/or due to some abnormal situation of the production or operation.*

4.2 Administrative Overheads: *Cost of all activities relating to general management and administration of an organisation.*

Administrative overheads need to be analysed in relation to production/manufacturing activities and other activities. Administrative overheads in relation to production/manufacturing activities shall be included in the manufacturing cost.

Administrative overheads in relation to marketing, projects management, corporate office or any other expense not related to the manufacturing activity shall be excluded from manufacturing cost.

4.3 Captive Consumption: *Captive Consumption means the consumption of goods manufactured by one division or unit and consumed by another division or unit of the same organization or related undertaking for manufacturing another product(s), as defined in section 4(3) of the Central Excise Act, 1944.*

4.4 Defectives: *End Product and/or intermediate product units that do not meet quality standards. This may include reworks or rejects.*

An intermediate product is a product that might require further processing before it is saleable to the ultimate consumer.

4.4.1 Reworks: *Defectives which can be brought up to the standards by putting in additional resources.*

Rework includes repairs, reconditioning, retro-fitment and refurbishing.

4.4.2 Rejects: *Defectives which cannot meet the quality standards even after putting in additional resources.*

Rejects may be disposed off as waste or sold for salvage value or recycled in the production process.

- 4.5 Depreciation:** Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, efflux of time or obsolescence through technology and market changes. Depreciation does not include impairment loss.

Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the estimated useful life of the asset.

Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less the estimated residual value.

Useful life of asset is either

- (i) the period over which a depreciable asset is expected to be used by the enterprise; or
- (ii) the number of production or similar units expected to be obtained from the use of the asset by the entity.

Depreciation that is charged in audited financial statement should be considered.

- 4.6 Direct Expenses:** Expenses relating to manufacture of an excisable good, which can be identified to such excisable good other than direct material cost and direct employee cost.

- 4.7 Employee Cost:** The aggregate of all kinds of consideration paid, payable and provisions made for future payments for the services rendered by employees of an enterprise (including temporary, part time and contract employees). Consideration includes wages, salary, contractual payments and benefits, as applicable or any amount paid or payable on behalf of employee. This is also known as Labour Cost.

4.7.1 Direct Employee Cost: The cost of employees which can be attributed to an excisable good in an economically feasible way.

4.7.2 Indirect Employee Cost: The cost of employees which cannot be directly attributed to a particular excisable good.

- 4.8 Interest and Finance Costs:** Costs incurred by an enterprise in connection with the borrowing of funds.

- 4.9 Manufacturing Cost:** Manufacturing cost of an excisable good is the aggregate of costs of all resources used in the process of its manufacturing.

Manufacturing cost includes cost of Materials (including process materials), Employee Cost, Cost of Utilities, Packing Cost, Direct Expenses, Repairs & Maintenance Cost, Pollution Control Cost, Quality Control Cost, Research & Development Cost, Cost of Inputs received free of cost or received at concessional value from the buyer of the excisable good, Depreciation and Amortisation (including amortisation cost of free tools, patterns, dies, drawings, blue prints, technical maps, charts, engineering, development, art work, design work, plans, sketches, packaging material and the like necessary for production of excisable goods), Cost of Rework, reconditioning, retro-fitment, Manufacturing Overheads, other costs allocable to such activity, adjustment for stock of work-in-process and recoveries for sales of scrap and wastages and the like but does not include expenses of the above nature incurred for post manufacturing purposes.

Manufacturing Cost and Cost of Production are used interchangeably.

- 4.10 Manufacturing Overheads: Indirect costs involved in the manufacturing process**

The terms Manufacturing Overheads, Factory Overheads, Works Overheads and Production Overheads have the same meaning and are used interchangeably. Manufacturing overheads shall include administration cost relating to production, factory, works or manufacturing and depot.

Manufacturing Overheads shall be classified on the basis of behaviour as Variable Manufacturing Overheads and Fixed Manufacturing Overheads.

Variable Manufacturing Overheads comprise of expenses which vary in proportion to the change in volume of production. For example, cost of utilities etc.

Fixed Manufacturing overheads comprise of expenses which does not change with the change in volume of production. For example, salaries, rent, repairs & maintenance, etc.



4.11 Material Consumed: Material Consumed includes materials directly identified for production of excisable goods such as:

- (a) Indigenous materials**
- (b) Imported materials**
- (c) Bought out items**
- (d) Self-manufactured items**
- (e) Process materials and other items**
- (f) Materials received free of cost or at concessional value from the buyer**
- (g) Accessories, on which cenvat credit is admissible, and which are cleared along with the final product**
- (h) goods used for providing free warranty for excisable goods**

Cost of material consumed consists of cost of material, duties and taxes, freight inwards, insurance and other expenditure directly attributable to procurement. Trade discount, rebates and other similar items are deducted for determining the cost of materials. Cenvat credit, credit for Countervailing Customs Duty, Sales Tax set off, VAT, duty draw back and other similar duties subsequently recovered/recoverable by the entity are also deducted.

4.12 Normal Capacity is the production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance.

Capacity may be determined in terms of units of production or equivalent machine or man hours.

4.13 Packing Material Cost: The cost of material of any nature used for the purpose of packing of excisable good.

4.14 Quality Control Cost: The quality control cost is the expenses incurred relating to quality control activities for adhering to quality standard. These expenses include salaries & wages relating to employees engaged in quality control activity and other related expenses.

4.15 Repairs & Maintenance Cost: Cost of all activities which have the objective of maintaining or restoring an asset in or to a state in which it can perform its required function at intended capacity and efficiency.

4.16 Research and Development Cost: The research and development cost incurred for development and improvement of the process or the excisable good.

4.17 Royalty: Royalty is compensation/periodic payments for the use of asset (tangible and/or intangible) to the owner for use of his asset in the production/manufacture, selling and distribution by an entity.

4.18 Scrap: Discarded material having some value in few cases and which is usually either disposed of without further treatment (other than reclamation and handling) or reintroduced into the production process.

4.19 Technical Know-how Fee: Technical Know-how Fee is a lump sum or periodical amount payable to provider of Technical Know-how in the form of design, drawings, training of personnel, or practical knowledge, skills or experience.

4.20 Waste and Spoilage:

4.20.1 Waste: Material lost during production or storage due to various factors such as evaporation, chemical reaction, contamination, unrecoverable residue, shrinkage, etc., and discarded material which may or may not have any value.

4.20.2 Spoilage: Production that does not meet with dimensional or quality standards in such a way that it cannot be rectified economically and is sold for a disposal value. Net Spoilage is the difference between costs accumulated up to the point of rejection and the salvage value.

5. Principles of Measurement

5.1 Manufacturing cost for each excisable good shall be measured separately.

5.2 Manufacturing cost of each excisable good shall be the aggregate of direct and indirect cost relating to manufacturing activity.

5.3 Material cost shall be measured separately for each type of material, that is, for indigenous material, imported material, bought out components and process materials, self-manufactured items, accessories for each type of excisable good.

Cost of Inputs received free of cost or at concessional value from the buyer of the excisable good shall be considered for determination of manufacturing cost.

5.4 The material cost of normal scrap/defectives which are rejects shall be included in the material cost of excisable goods manufactured. The material cost of actual scrap/ defectives, not exceeding the normal quantity shall be adjusted in the material cost of good production. Realized or realizable value of scrap or waste shall be deducted for determination of manufacturing cost. Material Cost of abnormal scrap /defectives should not be included in material cost but treated as loss after deducting the realisable value of such scrap / defectives.

5.5 Employee Cost for each excisable good shall be measured separately.

5.6 The cost of utilities consumed for manufacturing of excisable good shall be measured for each type of utility.

5.7 Packing material cost used for each type of excisable good shall be measured separately.

If excisable goods are transferred/discharged duly packed, the cost of such packing shall include cost of all types of packing in which the excisable goods are removed from the place of removal.

5.8 The Direct Expenses for manufacturing of excisable goods shall be measured for each excisable good separately.

5.9 Repairs and maintenance cost for manufacturing of excisable goods shall be measured for each excisable good separately.

5.10 Depreciation and Amortisation cost for manufacturing of excisable goods shall be measured for each excisable good separately.

5.11 Research & Development cost for manufacturing of excisable goods shall be measured for each excisable good separately.

5.12 Cost incurred for manufacturing of excisable goods after split-off point shall be measured for each Joint/By-Product.

In case the manufacturing process generates scrap or waste, realized or realizable value net of cost of disposal, of such scrap and waste shall be deducted from the cost of Joint Product.

5.13 Royalty and Technical Know-how Fee for manufacturing of excisable goods paid or incurred in lump-sum or which are in the nature of 'one-time' payment, shall be amortised on the basis of the estimated output or benefit to be derived from the related Technical Know how.

Royalty paid on sales shall not form part of manufacturing cost of excisable good.

5.14 Quality Control cost incurred in-house for manufacturing of excisable goods shall be the aggregate of the cost of resources used in the Quality Control activities in relation to each excisable good. The cost of resources procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts, taxes and duties refundable or to be credited as input credit.

5.15 Manufacturing Overheads for excisable goods representing procurement of resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts; taxes and duties refundable or to be credited as input credit.

Manufacturing Overheads other than those referred to above shall be determined on the basis of cost incurred in connection therewith.



- 5.16 **Any abnormal cost, where it is material and quantifiable, shall not form part of the manufacturing cost of excisable good.**
- 5.17 **Interest and other Finance costs are not part of manufacturing cost of excisable good.**
- 5.18 **Manufacturing cost of excisable good shall include cost of inputs received free of cost or at concessional value from the buyer of excisable good and amortisation cost of free tools, pattern, dies, drawings, blue prints, technical maps, charts, engineering, development, art work, design work, plans, sketches, and the like necessary for production of excisable good. It shall also include cost of rework, reconditioning, retro-fitment, Manufacturing Overheads and other costs allocable to such activity, adjustment for stock of work-in-process and recoveries from sales of scrap and wastages and the like necessary for production of excisable good.**

In case any input material, whether of direct or indirect nature, including packing material, is supplied free of cost or at concessional value by the buyer of the excisable good, the cost of such material shall be included in the manufacturing cost.

For example: Amortisation Cost of Moulds, Tools, Dies & Patterns and Cost of Packing Material etc. received free of cost or at concessional value from the buyer of excisable good shall be included in manufacturing cost.

- 5.19 **Any Subsidy/Grant/Incentive or any such payment received/receivable, from other entity, other than the buyer with respect to any manufacturing cost of excisable good shall be deducted for ascertainment of the manufacturing cost of excisable good to which such amounts are related.**
- 5.20 **The manufacturing cost of excisable good shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost.**
- 5.21 **Fines, penalties, damages, demurrage and similar levies paid to statutory authorities or other third parties shall not form part of the manufacturing cost of excisable good.**
- 5.22 **The forex component of imported material or other element of cost shall be converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise shall not form part of manufacturing cost of excisable good.**
- 5.23 **Credits/recoveries relating to the manufacturing cost, which are material and quantifiable, shall be deducted from the total manufacturing cost to arrive at the net manufacturing cost of excisable good.**
- 5.24 **Work in process/progress stock shall be measured at cost computed for different stages of completion.**

Stock of work-in-process/progress shall be valued at cost on the basis of stages of completion as per cost accounting principles. Opening and closing stock of work-in-process/progress shall be adjusted for computation of manufacturing cost of an excisable good.

6. Assignment of Cost

- 6.1 **While assigning various elements of manufacturing cost of excisable goods, traceability to an excisable good in an economically feasible manner shall be the guiding principle. The cost which can be traced directly to each excisable good shall be directly assigned.**
- 6.2 **Assignment of manufacturing cost of excisable goods, which are not directly traceable to the excisable good shall be based on either of the following two principles;**
- 6.2.1 **Cause and Effect – Cause is the process or operation or activity and effect is the incurrence of cost.**
- 6.2.2 **Benefits received – to be apportioned to various cost objects in proportion to the benefits received by them.**
- 6.3 **The variable manufacturing/production overheads shall be absorbed based on actual production.**
- 6.4 **The fixed manufacturing/production overheads and other similar item of fixed costs such as quality control cost, research and development costs and administrative overheads relating to manufacturing shall be absorbed in the manufacturing cost on the basis of the normal capacity or actual capacity utilization of the plant, whichever is higher.**

6.5 In case a production process results in more than one product being produced simultaneously, treatment of joint products and by-products shall be as under:

6.5.1 In case joint products are produced, joint costs are allocated between the products on a rational and consistent basis.

6.5.2 In case by-products are produced, the net realisable value of by-products is credited to the manufacturing cost of the main product.

6.6 Miscellaneous Income relating to production/manufacture shall be adjusted in the determination of manufacturing cost.

For example, income from sale of empty containers used for procurement of raw material shall be deducted in determination of manufacturing cost.

7. Presentation

7.1 Cost statement as per Appendix 1 to this standard or as near thereto shall present following information:

7.1.1 Actual capacity utilization in absolute terms and as a percentage of normal capacity.

7.1.2 Cost information relating to various elements of Cost shall be presented separately.

8. Disclosures

8.1 Disclosure shall be made only where material, significant and quantifiable.

8.2 If there is any change in cost accounting principles and practices during the period under review which may materially affect the manufacturing cost of excisable good in terms of comparability with previous period(s), the same shall be disclosed.

9. Effective date

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2015 for being applied for the preparation and certification of Cost Accounting Statements for excisable goods.

Appendix 1

Cost Statement showing Manufacturing Cost of (Name of excisable good) for the period: _____

	Name of the Manufacturer		
	Address of the Manufacturer		
	Excise Registration Number		
	Name of the unit		
	Address of the unit		
	Central Excise Tariff Heading		
A	Quantitative Information	Unit	Quantity
1	Normal/Installed Capacity		
2	Production		
3	Captive Consumption		
4	Production as %age of Normal/Installed Capacity		



B	Cost Information	Unit	Quantity	Rate	Amount	Cost per Unit
1	Materials (specify)					
	A					
	B					
	C					
	D					
	Total Materials Consumed					
2	Process Materials					
3	Utilities					
4	Direct Employee Cost					
5	Direct Expenses					
6	Consumable Stores and Spares					
7	Repairs and Maintenance Cost					
8	Quality Control Cost					
9	Research & Development Cost					
10	Technical Know-how Fee/Royalty, if any					
11	Depreciation/Amortization					
12	Other Manufacturing Overheads					
13	Total(1 to 12)					
14	Add/Less Work-in-Progress Adjustments					
15	Less Credit for Recoveries , if any					
16	Packing Cost					
17	Cost of Inputs Received Free or at concessional value from the buyer of the excisable good					
18	Manufacturing Cost (13 to 17)					

Date:

Seal & Signature of the
Company's Authorised Representative

I/We have verified above data on test check basis with reference to the books of account, cost accounting records and other records. Based on the information and explanations given to me/us, and on the basis of generally accepted cost accounting principles and practices and Cost Accounting Standards followed by the entity, I/we certify that the above cost data reflects true and fair view of the manufacturing cost of the above excisable good.

Date:

Seal & Signature of Cost Accountant

Place:

Membership No.:

Firm Regn. No. :

Note: Separate Cost Statement(s) shall be prepared for each excisable good

CAS-23

COST ACCOUNTING STANDARD ON OVERBURDEN REMOVAL COST

The following is the Cost Accounting Standard (CAS-23) on “**OVERBURDEN REMOVAL COST**” issued by the Council of the Institute of Cost Accountants of India. In this standard, the standard portions have been set in **bold italic** type. These are to be read in context of the background material which has been set in normal type.

1. Introduction

The standard deals with the principles and methods of measurement and assignment of Overburden Removal Cost and the presentation and disclosure in cost statements.

2. Objective

The objective of this standard is to bring uniformity, consistency in the principles, methods of determining and assigning Overburden Removal Cost with reasonable accuracy.

3. Scope

The standard shall be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Overburden Removal Cost including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified. Any term not defined in this Standard shall have the same meaning and expression as set out in the Glossary of Terms issued by the Council.

4.1 Abnormal cost: ***An unusual or atypical cost whose occurrence is usually irregular and unexpected and/or due to some abnormal situation of the production or operations.***

4.2 Administrative overheads: ***cost of all activities relating to general management and administration of an organization.***

4.3 Amortization: ***Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.***

4.4 Cost Object: ***This includes a product, service, cost centre, activity, sub-activity, project, contract, customer or distribution channel or any other unit in relation to which costs are ascertained.*** [Adapted from CIMA Terminology]

Activity includes mining operations also.

4.5 Current Ratio: ***the ratio of overburden removed to mineral produced in a particular patch of mine during the year.***

Quantity of mineral includes production and mineable mineral lying exposed.

Quantity of overburden removed is the net quantity after adjustment of opening and closing advance stripping quantities.

4.6 Depreciation: ***Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, efflux of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the estimated useful life of the asset.***

4.7 Imputed Costs: ***Hypothetical or notional costs, not involving cash outlay, computed for any purpose at any time.***



4.8 Interest and Finance Charges: Interest, including any payment in the nature of interest for use of non-equity funds and incidental cost that an entity incurs in arranging those funds

4.9 Mines overheads: indirect costs involved in the mining process for rendering services.

This relates to the activities of both Mineral extraction and Overburden Removal.

4.10 Mining Plan: It is the plan expected to provide information required to measure the stripping activity with reasonable consistency.

4.11 Overheads: Overheads comprise of indirect materials, indirect employee costs and indirect expenses which are not directly identifiable or allocable to a cost object.

4.12 Overburden: It is the overlying materials generally having no commercial value.

4.13 Overburden Removal cost: is the cost incurred to remove the overlying material from the mine site.

4.14 Ratio Variance: It is the variance between current ratio and standard /average stripping ratio in terms of quantity of mineral produced during the period.

4.15 Repair and Maintenance Cost: cost of all activities which have the objective of maintaining or restoring an asset in or to a state in which it can perform its required function at intended capacity and efficiency.

4.16 Stripping Activity: It is the activity of overburden removal that benefits the identified component of an ore to be mined by the entity.

4.17 Stripping Ratio: Stripping ratio is ratio of excavation of overburden to ore.

Generally overburden is measured in cubic metres and ore in tonnes. Therefore, the Stripping ratio is equal to Volume of overburden (m³)/ Weight of ore (in tonnes).

4.18 Standard stripping ratio: this is the ratio between the total quantity of overburden to be removed (in cubic meters) and the total mineral to be extracted (in tonnes) during the Projected life of the project.

The term Standard stripping ratio and Average stripping ratio denote the same meaning and are used interchangeably.

The Ratio shall be reviewed periodically, at least every five years, to take into account changes in geological factors such as actual behavior of the soil and the Ore body. The ratio shall be reviewed immediately if the geological factors alter radically, for example due to earthquake.

The reported quantity of Overburden is considered in cost statement where the variance between the reported quantity and the measured quantity is within the permissible limits. Reported quantity is the quantity of overburden that is necessary corresponding to actual quantity of mineral raised.

For example, 3:1 stripping ratio means that mining one Ton of ore will require mining three cubic meters of waste rock (overburden).

4.19 Advance Stripping: Advance Stripping is the excess overburden removed in between the overburden bench and assumed angle of repose drawn from the starting of Mineral bench from the surface of Mineral than what is needed for extraction of Mineral.

5. Principles of Measurement

5.1. Overburden Removal Cost shall be the aggregate of direct and indirect cost relating to overburden removal activity.

- 5.2. Direct cost includes the cost of consumable stores, spares like machinery spares, explosives and detonators, manpower, equipment usage, utilities, payment made directly to contractors and other identifiable resources consumed in such activity.**
- 5.3. Indirect cost includes the cost of resources common to various mining operation including overburden removal activity such as manpower, administrative overheads, loading and unloading equipment usage and other costs allocable to such activities.**
- 5.4 The overburden removal cost attributable to a development phase of a mine area shall be capitalised as non-current asset when it is probable that future economic benefits to the area will flow to the entity and such cost can be identified and measured separately.**
- 5.5 The overburden removal cost attributable to developed area of mine shall be charged to production of ore at the Standard stripping ratio.**

The cost of advance stripping activity whose economic benefit is likely to flow to the entity during the subsequent period, shall be capitalised and amortised.

If the removal of ore is more than the Standard stripping ratio, then the cost of short removal overburden shall be charged to the cost of production either by creating the reserve or by adjusting the earlier capitalized overburden removal cost.

- 5.6 Overburden shall be measured by multiplying the number of trips undertaken by equipment for Overburden removal or by any electronic mode. Measurement at regular intervals may be carried out by volume/ physical verification to arrive at fair quantity of overburden removed. Final assessment will be made based on scientific methodology.**
- 5.7 Current ratio is determined by dividing the actual overburden removed (net quantity after due adjustment for opening & closing advance stripping quantity) with the actual production of mineral including adjustment for mineable quantity of mineral lying exposed during the period.**
- 5.8 Cost of overburden removal activity carried out by outsourcing shall be determined at agreed price as per contract price including duties and taxes and other expenditure directly attributable thereto. The cost shall also include the cost of resources provided to the contractor by the company.**
- 5.9 Cost of overburden removal activity of each mine shall be computed and considered separately.**
- 5.10 Subsidy/ grant/ incentive or amount of similar nature received/ receivable with respect to overburden removal activity if any shall be reduced for ascertainment of the cost of the overburden removal for a patch/ plot to which the amounts are related.**
- 5.11 Any overburden removal cost resulting from some abnormal circumstances if material and quantifiable shall not form part of the overburden removal cost.**

Examples are fire, cave-in, flooding and other similar events of abnormal circumstances.
- 5.12 Fine, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the overburden removal cost.**
- 5.13 Interest & Finance charges incurred in connection with the overburden removal shall not form part of the overburden removal cost.**
- 5.14 Any change in the cost accounting principles applied for the determination of the overburden removal cost should be made only if it is required by law or for compliance with the requirements of a cost accounting standard or a change would result in a more appropriate preparation or presentation of cost statements of an enterprise.**



6. Assignment of costs

- 6.1** *Direct cost of overburden removal shall be assigned to the overburden removal activity.*
- 6.2** *The cost for equipment shall be assigned in the ratio of machine hours actually engaged for mineral and overburden removal or any other appropriate method that apportions the cost in an equitable manner.*
- 6.3** *Administrative overheads and other indirect expenses shall be apportioned to mineral and overburden on the basis of ratio of actual mineral produced and overburden removed during the period or on the basis of actual machine hours engaged for mineral extraction, and overburden removal or any other appropriate basis.*

7. Presentation

- 7.1.** *Overburden removal, absorption and cost details shall be presented separately for each mine.*

8. Disclosures

- 8.1** *The cost statements shall disclose the following:*

- (i)** *The basis of determining the overburden removal cost.*
- (ii)** *Where cost of removal is considered on the basis of standard ratio, any variation positive or negative from the current ratio.*
- (iii)** *Any subsidy grant/ incentive and any such payment reduced from the cost of overburden removal.*
- (iv)** *Credit/ recoveries relating to overburden removal.*
- (v)** *Any abnormal cost excluded from overburden removal cost.*
- (vi)** *Penalties and damages excluded from the overburden removal cost.*

- 8.2** *Disclosures shall be made only where material, significant and quantifiable.*

- 8.3** *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*

- 8.4** *Any change in the cost accounting principles and methods applied for the measurement and assignment of the overburden removal cost during the period covered by the cost statement which has a material effect on the overburden removal cost shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*

9. Effective date:

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April, 2017 for being applied for the preparation and certification of the General Purpose Cost Statements.

CAS - 24

COST ACCOUNTING STANDARD ON TREATMENT OF REVENUE IN COST STATEMENTS

The following is the COST ACCOUNTING STANDARD on "Treatment of Revenue in Cost Statements" (CAS-24) issued by the Council of the Institute of Cost Accountants of India. In this Standard, the standard portions have been set in **bold italic** type. These are to be read in the context of the background material which has been set in normal type.

1. Introduction

This standard deals with the principles and methods of classification, measurement, treatment and assignment of revenue and its presentation and disclosure in cost statements.

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles and methods for treatment of revenue in cost statements with reasonable accuracy.

3. Scope

This standard shall be applied to cost statements which require classification, measurement, treatment, assignment, presentation and disclosure of revenue including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified. Any term not defined in this Standard shall have the same meaning and expression as set out in the Glossary of Terms issued by the Council.

4.5 *By-product: Product with relatively low value produced incidentally in the manufacturing of the product or service.*

4.6 *Defectives: Materials, products or intermediate products that do not meet quality standards. This may include reworks or rejects.*

4.7 *Intermediate product: An intermediate product is a product that requires further processing before it is saleable.*

4.6 *Joint product: Products or services that are produced simultaneously, by the same process, identifiable at the end of the process and recognised as main products or services having sufficient value.*

4.7 *Net Sales Realization: is the revenue from operations net of discounts and indirect taxes.*

4.8 *Other Income: is the income that cannot be classified as revenue from operations.*

Examples:

- Profit on sale of fixed assets and investments;
- Interest from investments or deposits outside the business;
- Insurance claims received, not adjusted against an item of cost;
- Penalties or liquidated damages received, not adjusted against an item of cost;
- Fees received, not adjusted against an item of cost;
- Rent or lease from properties leased (unless the primary activity itself is leasing);
- Grants received;
- Royalties received (unless it is a part of major activity of the entity);



- Credits for previous years' adjustments;
- Dividend income on investments (other than in a financial enterprise);
- Gain on foreign currency transaction and translation (other than considered as finance cost);
- Excess provisions written back;
- Credits on account of revaluation of capital assets;
- All items of abnormal revenue such as recoveries from book debts written off in the previous period; and
- Prior period income.

4.16 Reporting Period: is the period for which the cost statements are prepared.

4.17 Revenue: The term Revenue will have the same meaning as assigned in the Accounting Standards notified by the Central Government under the Companies (Accounting Standards) Rules 2006 or in the Indian Accounting Standards notified under the Companies (Indian Accounting Standards) Rules 2015, as applicable.

The terms Revenue and Sales Realisation denote the same meaning and are used interchangeably.

4.9 Revenue from operations: is the income arising in the course of the ordinary activities of an entity from the sale of goods or rendering of services.

Revenue from operations represents income arising from the sale of goods or rendering of services and includes other operating revenue, such as sale of scrap, government subsidies, or incentives received. Revenue from operations is generally recognised at the net value excluding indirect taxes. Sometime, revenue is presented at the gross value including excise duty and the excise duty is presented as deduction from such gross value of the revenue.

Other Operating Revenue is the incidental income arising in the course of ordinary activities of an entity but not arising from the sale of main goods or services, and it does not include Other Income.

Examples:

- Sale of By-products;
- Sale of manufacturing scrap;
- Export incentives received from Government; and
- Product related subsidies or grants received from Government.

4.9 Rejects: Defectives which cannot meet the quality standards even after putting in additional resources.

4.10 Scrap: Discarded material having no or insignificant value and which is usually either disposed off without further treatment (other than reclamation and handling) or reintroduced into the process in place of raw material.

4.11 Spoilage: Production that does not meet the quality requirements or specifications and cannot be rectified economically.

4.12 Waste: Material lost during production or storage and discarded material which may or may not have any value.

Example of waste is hard waste and soft waste in textile industry.

5. Principles of Measurement

5.1 Revenue from sale of goods or services provided during a reporting period shall be measured based on the net sales realization.

5.2 Revenue from sale of joint products shall be measured separately for each main product or service sold.

- 5.3 Revenue from sale of goods or services shall be measured separately for each unit or location of an entity for each type of goods sold or service provided. It shall be sub-classified into revenue from exports, domestic sales, manufactured goods, operations, and trading activities.**
- 5.4 Revenue from sale of goods or services shall be measured separately for sale of each type of by-products, defectives, second grade products, rejects, scrap, spoilage, or wastes.**
- 5.5 If a by-product is further processed before sale, sales realisation of such by-product shall be net of further processing cost. Its net sales realisation shall be adjusted against the joint cost of production of relevant main products.**
- 5.6 Net Sales realization of defectives, second-grade products, rejects, scrap, spoilage, and waste products shall be adjusted against the cost of production of related goods sold.**
- 5.7 Revenue from sale of inputs, utilities, intermediate products, and shared or support services shall be adjusted against the cost of purchase or cost of production of the related input, utility, intermediate product and shared or support service.**
- 5.8 Other income shall not be considered in determining profit or loss as per cost accounts.**
- 5.9 Revenue generated from utilization of assets created under the CSR program shall not be considered in determining profit or loss as per cost accounts.**
- 5.10 Product or service related subsidies, grants, or incentives, received or receivable on sale of goods or rendering of services shall be part of revenue from operations and shall be identified with each product sold or service rendered.**
- 5.11 Any subsidy, grant, incentive or any such payment received or receivable to support the current operations of the entity other than those in the nature of capital grant and other than items referred in paragraph 5.10 above shall be treated as reduction in the related cost.**

Reference:

- para 5.6 of CAS-3, Cost Accounting Standard on Production and Operation Overheads;
- para 5.1.9 of CAS-6, Cost Accounting Standard on Material Cost;
- para 5.8 of CAS-7, Cost Accounting Standard on Employee Cost;
- para 5.8 of CAS-8, Cost Accounting Standard on Cost of Utilities;
- para 5.1.8 of CAS-9, Cost Accounting Standard on Packing Material Cost;
- para 5.7 of CAS-10, Cost Accounting Standard on Direct Expenses;
- para 5.5 of CAS-11, Cost Accounting Standard on Administrative Overheads;
- para 5.13 of CAS-12, Cost Accounting Standard on Repair and Maintenance Cost;
- para 5.6 of CAS-13, Cost Accounting Standard on Cost of Service Cost Centre;
- para 5.13 of CAS-14, Cost Accounting Standard on Pollution Control Cost;
- para 5.5 of CAS-15, Cost Accounting Standard on Selling and Distribution Overheads;
- para 5.4 of CAS-17, Cost Accounting Standard on Interest and Financing Charges;
- para 5.2 of CAS-18, Cost Accounting Standard on Research and Development Costs;



- para 5.6 of CAS-19, Cost Accounting Standard on *Joint Costs*;
- para 5.3 of CAS-20, Cost Accounting Standard on *Royalty and Technical Know-how Fee*;
- para 5.6 of CAS-21, Cost Accounting Standard on *Quality Control*; and
- para 5.19 of CAS-22, Cost Accounting Standard on *Manufacturing Cost*.

5.12 Any change in the cost accounting principles applied for the determination of revenue shall be made only if it is required by law or regulations or for compliance with the requirements of a cost accounting standard or the change would result in more appropriate preparation or presentation of cost statements of an entity.

6. Assignment of Revenue:

Revenue for each type of product or service shall be assigned directly to that product or service to the extent it is economically feasible.

Economic feasibility implies that it is practically feasible to assign the revenue to a particular product or service with reasonable cost and efforts. Reasonable cost and efforts are matters of judgment.

7. Presentation:

7.2 Net sales realization for each product or service shall be indicated separately for exports, domestic sales, manufactured goods, operations, and trading activities and matched against the cost of sales (net of duties) and margin of respective product or service.

7.3 The quantity of goods sold or services provided, where applicable, and selling price per unit shall be presented under each product or service.

8. Disclosures:

8.1 The cost statements shall disclose the following:

- 1. Revenue from sale of goods or services made to each related party with basis of determining the selling price;**
- 2. Revenue from by-products and costs of further processing after split-off point, reduced from cost of relevant product;**
- 3. Amount and nature of any subsidy, grant or incentive received or receivable and included in the revenue.**

8.2 Any change in the cost accounting principles and methods applied for the measurement and assignment of revenue during the period covered by the cost statement which has a material effect on the revenue shall be disclosed. Where the effect of such change is not ascertainable, wholly or partly, the fact shall be indicated.

8.3 Disclosures shall be made only where material, significant and quantifiable.

8.4 Disclosures shall be made in the body of the cost statements or as a foot note or as a separate schedule.

9. Effective date:

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April, 2017 for being applied for the preparation and certification of Cost Accounting Statement for goods sold and services provided.

4.2 GUIDANCE NOTES ON COST ACCOUNTING STANDARDS

The Institute had issued guidance notes on the Cost Accounting standards, from time to time, making it more explicit to understand the standards and for better application of the same in the record keeping and audit procedures. Normally the guidance notes are greatly required in the respect of the standards dealing with specific elements of cost, they may also be issued in respect of specific purpose standards also .

The Guidance Notes deals with principles and methods as provided in the respective CAS and practical aspects in connection with the subject matter of that CAS, as applicable in the determination of material cost of a product or service etc. So far the Institute has issue 11 Guidance Notes on various issues.

Serial No.	Title
1.	Guidance Note on CAS-2 (Revised 2015) Capacity Determination"
2.	Revised Guidance Note on Cost Accounting Standard on Cost of Production for Captive Consumption (CAS-4)
3.	Guidance Note on Cost Accounting Standard Material Cost (CAS-6)
4.	Guidance Note on Cost Accounting Standard on Employee Cost (CAS-7)
5.	Guidance Note on Cost Accounting Standard on Cost of Utilities (CAS-8).
6.	Guidance Note on Cost Accounting Standard on Packing Material Cost (CAS-9)
7.	Guidance Note on Cost Accounting Standard on Direct Expenses (CAS-10).
8.	Guidance Note on Cost Accounting Standard on Administrative Overheads (CAS-11).
9.	Guidance Note on Cost Accounting Standard on Repairs and Maintenance Cost (CAS-12).
10.	Guidance Note on Maintenance of Cost Accounting Records for Construction Industry Including Real Estate and Property Development Activity
11.	Guidance Note on Treatment of Costs Relating to Corporate Social Responsibility (CSR) Activities

These Guidance Notes explain in detail and clarifies on the various requirements of compliance of the relevant standards and will have the sections of introduction, scope, definitions and then the specific guidance on the treatment and disclosure aspects. *Students are advised, like in the case of standards, to thoroughly go through all the guidance notes on standards, issued by the Institute for better understanding of the standards and their compliance.*

The guidance notes on the standards dealing with specific elements of cost will normally have the following Chapters / sections, elaborating the contents of the respective CAS, in the same logical sequence, as in the standard:

1. Introduction
2. Definitions
3. Principles of Measurement
4. Assignment of Cost
5. Presentation
6. Disclosures and
7. Annexures, as the need may be.



4.3 GENERALLY ACCEPTED COST ACCOUNTING PRINCIPLES (GACAP)

1. Introduction

The compilation of Generally Accepted Cost Accounting Principles (GACAP) by the Institute of Cost and Accountants of India is a unique effort to record principles and practices in the discipline of Cost Accountancy in India, which takes into consideration the global practices as well. There have been compilations of financial accounting principles such as Paul Grady's work. ("Inventory of generally accepted accounting principles", American Institute of Certified Public Accountants, New York, 1961). While cost data is being used by various stakeholders, the focus has been more on management use. The absence of institutionalization of external cost reporting might explain this lacuna in theory. The Cost Accounting Standards issued by the Cost Accounting Standards Board in the United States is the nearest to such compilation though this is in the context of Defence Contract Costing.

The formalization of Cost Accounting Principles in use in India started acquiring a more cohesive form in the regime of administered prices ushered in the 1950 through the work of Tariff Commission mandated to fix tariffs and prices in a variety of industries. The movement acquired further fillip through the work of other statutory price-fixing authorities including the Bureau of Industrial Costs and Prices, Cost Accounts Branch of Ministry of Finance. Since the price enquiries by these bodies covered a wide range of industries, industry specific practices started unifying into a common body of cost accounting principles.

The introduction of the regulated and non-regulated sector wise Companies (Cost Records and Audit) Rules, 2014 further strengthened the evolution of a uniform body of cost accounting principles. Even though intended to prescribe the Cost Accounting records to be maintained by various industries, the Rules carried nuggets of Cost Accounting principles in the body of the Rules and in footnotes to format of prescribed cost statements. When some of these got repeated in the Rules prescribed for different industries, it helped towards the evolution of a generally accepted set of cost accounting principles. Thus the Rules contained directions on valuation of purchased materials (all direct costs upto the works), the treatment of major repairs (to be prorated over the period of benefit derived by such repairs), the costing of transfers of raw materials from own farms (sugar cane at government controlled price) and the like. It, however, cannot be denied that the Rules framed from time to time did have certain contradictions – for example, the valuation of sugarcane from own farm to be valued at market price and valuation of wood from own forest to be valued at cost – but the Companies (Cost Records and Audit) Rules, 2014 did play a major role in unifying cost accounting principles as applied to various industries.

Similarly the regulatory agencies in charge of individual industries, particularly Fertilizer Industry Co-ordination Committee, Drug Price Control Authority, Central Electricity Regulatory Commission and Telecom Regulatory Authority of India, all played a role in evolving a more consistent set of cost accounting principles.

The Companies (Cost Records and Audit) Rules, 2014 did not lay down any cost accounting principles as such but by requiring disclosure of principles and methods used, it focused attention on them.

The requirement for determination of cost of production of manufactured goods used for captive consumption further focussed attention on the subject of GACAP. According to the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, the assessable value of goods used for captive consumption is 110% of cost of production of such goods and as may be prescribed by the Government from time to time. The cost accounting principles for determination of cost of production were also well established. Their codification and standardization in a single document viz. Cost Accounting Standard 4 (CAS 4) issued on January 3, 2003 became a landmark event. The standard contains a format for reporting the cost of production of products manufactured for captive consumption. The Certificate for the cost statement carried a reference to the basis being "Generally Accepted Cost Accounting Principles and Practices". Thus was born the phrase forming the title of this document.

The Expert Group constituted by the Ministry of Corporate Affairs under the Chairmanship of **Mr. B.B. Goyal, Advisor (Cost), Ministry of Corporate Affairs, Government of India** acknowledged the existence of an un-codified set of generally accepted cost accounting principles in use in Indian industries and by the practicing cost accountants for attestation of Cost Statements. The Expert Group suggested that the principles be codified to provide a formal

basis for the practice of Cost Accounting. The Expert Group also recommended review of alternate treatment of items in cost accounting thus eliminating needless diversities in practice leading to the development of cost accounting standards.

The Ministry of Corporate Affairs decided to implement the recommendations of the Expert Group and notified the Companies (Cost Records and Audit) Rules, 2014 on 30th June, 2014. These Rules introduced a common set of record rules for industries other than regulated industries specified in the Rules, in place of industry specific rules in vogue earlier. The Rules require every company to which the rules apply, including all units and branches thereof, to keep cost records in respect of each of its products and activities on regular basis. The cost records are to be maintained in accordance with the **generally accepted cost accounting principles** and **cost accounting standards** issued by the Institute of Cost Accountants of India to the extent these are found to be relevant and applicable. The variations, if any, are to be clearly indicated and explained.

The present effort of codifying the GACAP and presenting them in a single volume is the culmination of all the above developments in the practice of cost accounting in India.

Whereas Cost Accounting Standard 4 (CAS 4) issued in 2003 focused attention on GACAP, the Companies (Cost Records and Audit) Rules, 2014 which require maintenance of cost records according to GACAP and Cost Accounting Standards gave the mandate for a compilation of GACAP. Moreover, the supersession of the erstwhile industry-wise detailed Rules providing guidance on cost accounting principles and practices to be followed by the companies further necessitated the issuance of this document.

2. Objectives

The objectives of this document are:

1. to codify the GACAP as applied in the Indian industry;
2. to narrow down diversities in cost accounting practices facilitating the process of development of cost accounting standards;
3. to provide a reference source to industry and practitioners in preparation and attestation of Cost Statements, where specific cost accounting standards are yet to be issued;
4. to provide a reference source to all the stakeholders in the understanding and interpreting the cost statement; and,
5. to provide a base for monitoring the evolution of new concepts and practices in cost accounting and to codify them as and when they become generally accepted.

3. Scope

The scope is to codify the cost accounting principles to be followed by business and other entities in India in preparing and presenting cost information – more particularly the General Purpose Cost Statements covered by Cost Audit. This document also encompasses the generally accepted cost accounting practices presently being followed by such entities.

4. Nature of Content and Format

1. This document titled Generally Accepted Cost Accounting Principles (GACAP) contains a summary of the Cost accounting principles currently followed by business entities in India in preparing and presenting cost information in the context of general purpose cost statements for statutory reporting and covered by Cost Audit.
2. It explicitly incorporates the principles already contained in the Cost Accounting Standards 1-22 issued by the Cost Accounting Standards Board (CASB) in India without necessarily repeating them.
3. In areas not covered by the standards, it reflects the cost accounting principles found in the Companies (Cost Records and Audit) Rules, 2014.
4. Where somewhat conflicting principles have been laid down by the Companies (Cost Records and Audit) Rules, 2014 in different industries, attempt has been made to harmonize the principles so as to evolve a



generally acceptable framework. Where use of alternate principles are sanctioned by the Rules or where alternate principles are applied in practice in the absence of explicit guidance in Rules, the alternates have been mentioned with an indication of the preferred practice.

5. Because the Rules were framed at different points of time spread over many years, it is likely that the principles contained in the Rules and the practice based on them do not reflect current concepts. In such cases, the document reflects the current concepts.
6. It also reflects the Cost Accounting Principles contained in the Guidance Notes and other publications issued by ICAI from time to time.
7. Cost Accounting principles which are gathering wide spread acceptance in Indian Companies for management reporting, even though not adopted for statutory cost reporting (for example, Activity Based Costing), are mentioned with suitable caveats regarding their lack of applicability for general purpose cost statements for statutory reporting, where applicable.
8. The document stipulates the main principles in **bold letters** followed by explanation in normal type.

5. Conceptual Frame Work

There is a need for a conceptual frame work that underlies the GACAP detailed in the succeeding sections. The conceptual frame work, as the name suggests, is a frame work and not a superset of cost accounting principles. It does not attempt to lay down a principle for any particular costing issue or to amplify the GACAP. The frame work helps to understand the GACAP that follow, in the appropriate perspective and guides in modifying them or developing new principles;

- **Focus on drivers of value**

Costing is necessary for an informed understanding of the organizational drivers of cost, revenue, profits and value. Costing has to fulfil this role both in a historical and in a forward looking context.

- **Cost for a purpose**

Over a long time it has been recognized that there is a cost concept relevant for a purpose. Thus external reporting requires historical and full absorption costing while performance evaluation requires attention directing and diagnostic information; planning and decision making requires analytical and predictive information. It is, therefore, not possible for the same set of cost data to fit all purposes, thereby resulting in a wide range of cost concepts from which preparers and users of cost information choose a concept relevant to the purpose.

- **Reality driven**

Cost models must reflect the entity's business model, its operational processes, its strategy, its organizational structure and its competitive environment. Organizational processes and activities drive the costs and these are in turn influenced by other factors mentioned above.

- **Materiality and cost effectiveness**

The selection of the methods of implementing the costing principles should have regard to the issues of materiality and cost effectiveness. Materiality of cost information is to be judged from the perspective of the user of that information. The degree of detail and accuracy required are governed by the perspective of materiality. From the preparers' viewpoint there is the need to balance the cost of maintaining a cost accounting system with corresponding benefits. This is the reason why in a number of places, while dealing with methods of implementing cost accounting principles, the expression "economically feasible way" has been used in this document.

Hence, for preparation and disclosure of cost information, one is required to judge the materiality aspect in conjunction with economic feasibility of maintaining such data and information. For example, maintenance of product/activity-wise cost details for each of the ancillary product or activity of an entity would neither be material nor economically feasible.

Any product or activity of an entity which is incidental to its main operations and does not constitute its main line of business and whose total turnover from the sale/supply of such product or activity does not exceed 2% of the total turnover of the entity or ₹20 crores, whichever is lower, should be treated as an ancillary product or activity.

- **Comparability and consistency**

Cost information should be prepared and presented in a way which provides for comparability over time and consistency. The methods used for preparing and presenting cost information should be changed only where for valid reasons such as those required by law, compliance with new cost accounting standards or on the ground that it would result in a more appropriate presentation of cost information.

- **Transparency and auditability**

Since cost information is used generally by various stakeholders like management, regulators and Government with a business outlook, there is a need for transparency regarding the definitions used and sources of data. It should be possible for those who wish to review such cost information to follow an audit trail. Auditability of cost information is a prerequisite to the effective use of such information.

6. Definitions

Abnormal cost: *An unusual or atypical cost whose occurrence is usually irregular and unexpected and / or due to some abnormal situation of the production or operation.*

Abnormal idle Capacity: *Abnormal idle capacity is the difference between normal capacity and actual capacity utilization where the actual capacity is lower than the normal capacity.*

Abnormal Idle time: *An unusual or atypical idle time occurrence of which is irregular and unexpected or due to some abnormal situations.*

E.g. Idle time due to a strike, lockout or an accident

Absorption of overheads: *Assigning of overheads to cost objects by means of appropriate absorption rate.*

Overhead Absorption Rate = $\frac{\text{Overheads of the Cost object}}{\text{Quantum of base}}$.

Actual Capacity Utilization: *Actual Capacity Utilization is the volume of production achieved or service provided in a specified period, expressed as a percentage of installed capacity.*

Administrative Overheads: *Cost of all activities relating to general management and administration of an entity.*

Administrative overheads shall exclude production overheads, marketing overheads and finance cost. Production overheads includes administration cost relating to production, factory, works or manufacturing.

Allocation of overheads: *Allocation of overheads is assigning total amount of an item of cost directly to a cost object.*

An item of expense which can be directly related to a cost centre is to be allocated to the cost centre. For example, depreciation of a particular machine should be allocated to a particular cost centre if the machine is directly attached to the cost centre.

Apportionment of overhead: *Assigning of overhead is distribution of overheads to more than one cost objects on some equitable basis.*

When the indirect costs are common to different cost centres, these are to be apportioned to the cost centres on an equitable basis. For example, the expenditure on general repair and maintenance pertaining to a department can be allocated to that department but has to be apportioned to various machines (Cost Centres) in the department. If the department is involved in the production of a single product, the whole repair & maintenance of the department may be allocated to the product.

Captive Consumption: *Captive Consumption means the consumption of goods manufactured by one division or unit and consumed by another division or unit of the same entity or related undertaking for manufacturing another product(s).*



Cartage: *The expenses incurred for movement of goods covering short distance for further transportation for delivery to customer or storage.*

Collection of Overheads: *Collection of overheads means the pooling of items of indirect expenses from books of account and supportive / corroborative records in logical groups having regards to their nature and purpose.*

Overheads are collected on the basis of pre-planned groupings, called cost pools. Homogeneity of the cost components in respect of their behaviour and character is to be considered in developing the cost pool. Variable and fixed overheads should be collected in separate cost pools under a cost centre. A great degree of homogeneity in the cost pools are to be maintained to make the apportionment of overheads more rational and scientific. A cost pool for maintenance expenses will help in apportioning them to different cost centres which use the maintenance service.

Committed Cost: *The cost of maintaining stand-by utilities shall be the committed cost.*

Cost: *Cost is a measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services.*

Manufacturing of goods or rendering services involves consumption of resources. Cost is measured by the sacrifice made in terms of resources or price paid to acquire goods and services. The type of cost is often referred in the costing system depends on the purpose for which cost is incurred. For example material cost is the price of materials acquired for manufacturing a product.

Cost Centre: *Any unit of an entity selected with a view to accumulating all cost under that unit. The unit can be division, department, section, group of plant and machinery, group of employees or combination of several units.*

Cost Centre or Cost Object is the logical sub-unit for collection of cost. Cost Centre may be of two types – personal and impersonal cost centres. Personal cost centre consists of a person or a group of persons. Cost centres which are not personal cost centres are impersonal cost centres. Again Cost centres may be divided into broad types i.e. Production Cost Centres and Service Cost Centres. Production Cost Centres are those which are engaged in production like Machine shop, Welding shop, Assembly shop etc. Service Cost centres are for rendering service to production cost centre like Power house, Maintenance, Stores, Purchase office etc.

Cost Object: *An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.*

Cost of Production: *Cost of production of a product or a service consists of cost of materials consumed, direct employee costs, direct expenses, production overheads, quality control costs, packing costs, research and development costs and administrative overheads relating to production.*

To arrive at cost of production of goods dispatched for captive consumption, adjustment for Stock of work-in-Process, finished goods, recoveries for sales of scrap, wastage etc shall be made.

Cost of Transportation: *Cost of Transportation comprises of the cost of freight, cartage, transit insurance and cost of operating fleet and other incidental charges whether incurred internally or paid to an outside agency for transportation of goods but does not include detention and demurrage charges.*

Cost of transportation is classified as inward transportation cost and outward transportation Cost.

Cost unit: *Cost unit is a form of measurement of volume of production of a product or a service. Cost unit is generally adopted on the basis of convenience and practice in the industry concerned.*

Current Asset: *An entity shall classify an asset as current when:*

- (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle; (b) it holds the asset primarily for the purpose of trading;*
- (c) it expects to realise the asset within twelve months after the reporting period; or*
- (d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability.*

Current liabilities: *A entity shall classify a liability as current when:*

- (a) It is expected to settle the liability in its normal operating cycle*
- (b) It holds the liability primarily for the purpose of trading*
- (c) the liability it is due to be settled within twelve months after the reporting period ; or*
- (d) the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.*

Defectives: *Materials, products or intermediate products that do not meet quality standards. This may include reworks or rejects.*

Depot: *Depot is the bounded premises / place managed internally or by an agent, including consignment agent and C & F agent, franchisee for storing of materials / goods for further dispatch including the premises of Consignment Agent and C&F Agent for the purpose.*

Depot includes warehouses, go-downs, storage yards, stock yards etc.

Direct Expenses: *Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost.*

Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.

Direct Employee Cost: *Employee cost, which can be attributed to a cost object in an economically feasible way.*

Direct Material Cost: *The cost of material which can be attributed to a cost object in an economically feasible way.*

Distribution Overheads: *Distribution overheads, also known as distribution costs, are the costs incurred in handling a product or service from the time it is ready for despatch or delivery until it reaches the ultimate consumer including the units receiving the product or service in an inter-unit transfer.*

For example:

- Secondary packing
- Transportation cost
- Warehousing cost
- Cost of delivering the products to customers etc.
- Clearing and forwarding charges
- Cost of mending or replacing packing materials at distribution point.

Employee Cost: *Benefits paid or payable for the services rendered by employees (including temporary, part time and contract employees)of an entity.*

Explanation:

1. Contract employees include employees directly engaged by the employer on contract basis but does not include employees of any contractor engaged in the organisation.
2. Compensation paid to employees for the past period on account of any dispute / court orders shall not form part of Employee Cost.
3. Short provisions of prior period made up in current period shall not form part of the employee cost in the current period.



Employee cost includes payment made in cash or kind.

For example:

- **Employee cost**
 - Salaries, wages, allowances and bonus / incentives.
 - Contribution to provident and other funds.
 - Employee welfare
 - Other benefits
- **Employee cost – Future benefits**
 - Gratuity.
 - Leave encashment.
 - Other retirement/separation benefits.
 - VRS/ other deferred Employee cost.
 - Other future benefits
- **Benefits generally include actual cost of**
 - Paid holidays.
 - Leave with pay.
 - Statutory provisions for insurance against accident or health scheme.
 - Statutory provisions for workman's compensation.
 - Medical benefits to the Employees and dependents.
 - Free or subsidised food.
 - Free or subsidised housing.
 - Free or subsidised education to children.
 - Free or subsidised canteen, crèches and recreational facilities.
 - Free or subsidised conveyance.
 - Leave travel concession.
 - Any other free or subsidised facility.
 - Cost of Employees' stock option.

Equalized Freight: *Equalized Freight means average freight.*

Equalized Transportation Cost: *Equalized Transportation Cost means average transportation cost incurred during a specified period.*

Excess Capacity Utilization: *Excess Capacity Utilization is the difference between installed capacity and the actual capacity utilization when actual capacity utilization is more than installed capacity.*

Fixed Cost: *Fixed costs are costs which do not vary with the change in the volume of activity. Fixed indirect costs are termed fixed overheads.*

Freight: *Freight is the charges paid or payable for transporting materials/ goods from one location to another.*

Idle Capacity: *Idle Capacity is the difference between installed capacity and the actual capacity utilization when actual capacity utilization is less than installed capacity.*

Idle time: *The difference between the time for which employees are paid /payable to employees and the employees' time booked against cost objects.*

The time for which the employees are paid includes holidays, paid leave and other allowable time offs such as lunch, tea breaks.

Imputed Costs: *Notional cost, not involving cash outlay, computed for any purpose.*

Indirect Employee Cost: *Employee cost, which cannot be directly attributed to a particular cost object.*

Indirect Materials: *Materials, the costs of which cannot be directly attributed to a particular cost object.*

Installed Capacity: *Installed capacity is the maximum capacity of producing goods or providing services, according to the manufacturer's specifications or determined through an expert study.*

Intangible Asset: *An intangible asset is an identifiable non-monetary asset without physical substance*

Interest and Finance charges: *Interest, including any payment in the nature of interest for use of non equity funds and incidental cost that an entity incurs in arranging those funds.*

This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs. The terms Finance costs and Borrowing costs are used interchangeably.

Inward Transportation cost: *Inward Transportation cost is the transportation expenses incurred in connection with materials/goods received at factory or place of use or sale/removal.*

Licensed Capacity: *Licensed Capacity is the production capacity of the plant for which license has been issued by an appropriate authority.*

Marketing overheads: *Marketing overheads comprise of selling overheads and distribution overheads.*

Material Cost: *The cost of material used for the purpose of production of a product or rendering a service.*

Normal capacity: *Normal Capacity is the production achieved or achievable on an average over a number of periods or seasons under normal circumstances taking into account the loss of capacity resulting from planned maintenance.*

Outward Transportation Cost: *Outward Transportation Cost is the transportation expenses incurred in connection with the sale or delivery of materials or goods from factory or depot or any other place from where goods are sold /removed.*

Overheads: *Overheads comprise costs of indirect materials, indirect employees and indirect expenses.*

Overtime Premium: *The extra amount payable beyond the normal wages and salaries for beyond the normal working hours.*

Packing Materials: *Materials used to hold, identify, describe, store, protect, display, transport, promote and make the product marketable.*

Packing Material Cost: *The cost of material of any nature used for the purpose of packing of a product.*

Packing Material Development Cost: *Cost of evaluation of packing material such as pilot test, field test, consumer research, feedback, and final evaluation cost.*

Practical or Achievable Capacity: *Practical or Achievable Capacity is the maximum productive capacity of a plant reduced by the predictable and unavoidable factors of interruption pertaining to internal causes.*

Thus, practical capacity is the installed capacity minus the inevitable interruptions due to time lost for preventive maintenance, repairs, set ups, normal delays, weekly off-days and holidays etc. Practical capacity does not consider the external factors causing reduction in production e.g. lack of orders.

Primary Packing Material: *Packing material which is essential to hold and preserve the product for its used by the customer..*



For example:

- Pharmaceutical industry: Insertions related to product, Foils for strips of tablets/capsules, vials.
- Industrial gases: Cylinders / bottles used for filling the gaseous products
- Confectionary Industry: Butter paper and wrappers.

Production Overheads: *Indirect costs involved in the production of a product or in rendering service.*

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

Rejects: *Defectives which cannot meet the quality standards even after putting in additional resource*

Rejects may be disposed off as waste or sold for salvage value or recycled in the production process.

Repairs and Maintenance Cost: *Cost of all activities which have the objective of maintaining or restoring an asset in or to a state in which it can perform its required function at intended capacity and efficiency.*

Repairs and Maintenance activities for the purpose of this standard include routine or preventive maintenance, planned (predictive or corrective) maintenance and breakdown maintenance. The repair or overhaul of an asset which results in restoration of the asset to intended condition would also be a part of Repairs and Maintenance activity. Major overhaul is a periodic (generally more than one year) repair work carried out to substantially restore the asset to intended working condition.

Research & Development Cost:

Development cost: *Development cost is the cost for application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.*

Research cost: *Research cost is the cost of original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding*

Research Cost comprises the cost of development of new product and manufacturing process; improvement of existing products, process and equipment; finding new uses for known products; solving technical problem arising in manufacture and application of products etc. Development cost includes the cost incurred for commercialization / implementation of research findings.

Reusable Packing Material: *Packing materials that are used more than once to pack the product.*

Reworks: *Defectives which can be brought up to the standards by putting in additional resources.*

Rework includes repairs, reconditioning and refurbishing.

Scrap: *Discarded material having no or insignificant value and which is usually either disposed off without further treatment (other than reclamation and handling) or reintroduced into the process in place of raw material.*

Secondary Packing Material: *Packing material that enables to store, transport, inform the customer, promote and otherwise make the product marketable.*

For example:

- Pharmaceutical industry: Cartons used for holding strips of tablets and card board boxes used for holding cartons.
- Textile industry: Card board boxes used for holding cones on which yarn is woven.
- Confectionary Industry: Jars for holding wrapped chocolates, Cartons containing packs of biscuits.

Selling Overheads: *Selling overheads are the expenses related to sale of products or services and include all indirect expenses incurred in selling the products or services.*

Semi Variable Costs: *Semi variable costs are the costs that contain both fixed and variable elements. They partly change with the change in the level of activity.*

Spoilage: Production that does not meet the quality requirements or specifications and cannot be rectified economically.

Standard Cost: A predetermined cost of a product or service based on technical specifications and efficient operating conditions.

Standard costs are used as scale of reference to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

Stand-by Service: Any facility created as backup against any failure of the main source of service.

Stand-by Utilities: Any utility created as backup against any failure of the main source of utilities.

Support- Service Cost Centre: The cost centre which primarily provides auxiliary services across the entity.

The cost centre which provides services to Production, Operation or other Service Cost Centre but not directly engaged in manufacturing process or operation is a service cost centre. A service cost centre renders services to other cost centres / other units and in some cases to outside parties.

Examples of service cost centres are engineering, workshop, research & development, quality control, quality assurance, designing, laboratory, welfare services, safety, transport, Component, Tool stores, Pollution Control, Computer Cell, dispensary, school, crèche, township, Security etc.

Administrative Overheads include cost of administrative Service Cost Centre.

Transit Insurance Cost: Transit Insurance Cost is the amount of premium to be paid to cover the risk of loss /damage to the goods in transit.

Utilities: Significant inputs such as power, steam, water, compressed air and the like which are used for manufacturing process but do not form part of the final product.

Variable Cost: Variable Costs are the cost which tend to directly vary with the volume of activity.

Waste: Material lost during production or storage and discarded material which may or may not have any value.

7. Principles applicable to Elements of Cost

The following section deal with GACAP applicable to individual elements of cost.

Before proceeding with element-wise principles, it is useful to summarise the principles applicable to all elements of cost.

1. When an element of cost is accounted at standard cost, variances due to normal reasons are treated as a part of the element-wise cost. Variances due to abnormal reasons will not form part of the cost.
2. Any Subsidy/Grant/Incentive and any such payment received/receivable with respect to the input cost is reduced from cost for ascertainment of the cost of the cost object to which such amount pertains.
3. Any abnormal cost where it is material and quantifiable will not form part of the cost.
4. Penalties, damages paid to statutory authorities or other third parties will not form part of the cost.
5. Costs reported under various elements of cost will not include imputed costs.
6. Finance costs incurred in connection with acquisition of resources such as materials, utilities and the like will not form part of the cost of such resources.
7. Any credits or recoveries from employees or suppliers or other parties towards costs incurred by the entity for a resource will be netted against such costs.
8. Except otherwise stated, the measurement of costs for cost accounting purposes will follow the same principles as set out in Generally Accepted Accounting Principles, applicable to the concerned entity.

MATERIAL COST

1. Material Cost usually includes all costs required to bring the materials to the present condition and location.

In case of manufacturing units, the location means the factory gate / works. In case of service organisation, the location means the place from which the services are rendered or activities are carried out.



2. **Material receipt is valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited by the taxing authorities) that can be quantified with reasonable accuracy at the time of acquisition¹.**

The test that the expenditure must be capable of being quantified with reasonable accuracy at the time of acquisition is significant. For large volume small value purchases, it is usual to take freight or other costs at a predetermined percentage of purchase prices and recognise any difference as expense for the period when actual costs are booked as expenses of the period. For small value items of purchase, it is usual even to treat all freight on such purchases as overheads.

3. **Procurement costs are not generally included in material cost. However, those costs which can be directly identified with a material are included in the material cost.**

Purchase Department Overheads are not generally included in material cost. But the procurement expenses incurred at Collection Centres in the Paper Industry such as Salaries & Wages, Stores, Repairs & Maintenance, Other Expenses, Share of Forest Development Expenses, if any, are included as part of the cost of wood. Similarly expenses incurred at Cane Collection Centres are included in the cost of sugar cane procured by a Sugar Mill.

4. **Development expenses incurred in respect of materials procured is included in the cost of material to the extent that the material procured is the result of such developments.**

For example, the Forest Development Expenses incurred by a paper mill is included in the cost of wood on an equitable basis. It is usual to relate the development expenses to the area under development and charge a share to the quantity of wood received during the period as a proportion of expected yield. It is less preferable to charge the Forest Development Expenses as period cost and charge the whole of it to the quantity of wood procured during the period.

5. **Where a material is acquired in exchange for other materials or services supplied, the cost of material acquired is taken as the cost of material supplied or services provided plus other applicable costs such as freight.**

In the Paper industry where bagasse from the Sugar mills is obtained by the paper mill by supplying coal to the sugar mills, in the cost statement, the cost of coal supplied is considered as the cost of bagasse procured.

6. **Normal loss or spoilage of material prior to reaching the factory or at places where the services are provided is absorbed in the cost of balance of materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal².**

7. **Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture etc., before the material is received is absorbed in material cost to the extent they are normal, with corresponding adjustment in the quantity³.**

8. **Where the material procured represents an agricultural produce from own sources, the same is valued at market price or cost where it can be determined with reasonable accuracy.**

The cane supplied from own farm to a Sugar Mill is charged at state advisory price/ control rate and profit/ loss on farm taken to profit & loss account directly. This is permitted by the Companies (Cost Records and Audit) Rules, 2014 for Sugar Industry. Such a treatment is advised where the correct determination of cost of the production of items procured from own farm, is fraught with difficulty. Costing of agricultural produce in many cases has not reached a level of maturity that the cost of an item produced by an agricultural process can be used in a General Purpose Cost Statement subject to attest function. The use of a fair market value is indicated in such cases. However in the Paper industry, where bamboo/wood is grown in forests owned or taken on lease by the company and collection is made by departmental operations or by contract, detailed

1 CAS 6 Paragraph 5.1.1

2 CAS 6 Paragraph 5.1.5

3 CAS 6 Paragraph 5.1.6

records are generally maintained in a suitable form so as to enable computation of the cost of such bamboo or wood. In such cases, cost is taken as the basis of valuation of material. Similar is the case of cost of green leaf produced in tea plantations where cost of green leaf produced can be determined based on detailed plantation records maintained for the purpose.

9. **The forex component of imported material cost is converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise will not form part of the material cost⁴.**
10. **Self Manufactured Materials (and Self manufactured components and sub assemblies) are valued at cost including Direct Material Cost, Direct Employee Cost, Direct Expenses, Factory Overheads and share of Administrative Overheads relating to production. Share of other Administrative Overheads, Finance Cost and Marketing Overheads are excluded⁵.**
11. **The material cost of normal scrap/defectives, which are rejects, is included in the material cost of goods manufactured. This cost not exceeding the normal is adjusted in the material cost of good production. Material cost of abnormal scrap/defectives should not be included in the material cost, but treated as loss after giving credit to the realizable value of such scrap/defectives⁶.**
12. **Issues of materials are valued using appropriate assumptions on cost flow⁷.**
Examples are FIFO, LIFO, and Weighted Average rate.
13. **Material Costs are assigned to cost objects on the basis of material quantity consumed where traceable and where not traceable on technical norms or estimates⁸.**
14. **When material is processed or part manufactured by a third party according to specifications provided by the buyer, the processing/ manufacturing charges payable to the third party is treated as part of the material cost⁹.**
15. **When the part of the manufacturing operations/activity is subcontracted, the subcontract charges related to materials is treated as direct expenses and assigned directly to the cost object¹⁰.**
16. **Cost of materials like catalysts, dies, tools, patterns etc., which are relatable to production over a period of time, is amortized over the production units benefited by such cost. Cost of materials with life exceeding one year is included in the cost over the useful life of the material¹¹.**
17. **Where the cost of materials is written off or written down in the financial books as per the accounting policy followed by the entity, such write off or write down amount is not treated as cost.**

It is usual for the companies to write off or write down the cost of non-moving / slow-moving items, say items which have not moved for three years or more.

18. **When the material referred to in paragraph 17 above, is subsequently issued, the issue is valued at the original cost in cost accounting records and the difference between the original cost and the carrying amount is presented in the reconciliation statement, wherever, economically feasible.**

When it is not economically feasible to apply the above principle, the issue is valued at the carrying amount in the cost accounting records.

4 CAS 6 Paragraph 5.1.7

5 CAS 6 Paragraph 5.1.3, 5.3

6 CAS 6 Paragraph 5.4

7 CAS 6 Paragraph 5.2.1

8 CAS 6 Paragraph 6.3.1

9 CAS 6 Paragraph 6.2.1

10 CAS 6 Paragraph 6.2.2

11 CAS 6 Paragraph 6.3.2



EMPLOYEE COST

1. Employee cost or Labour cost is ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all benefits¹².
2. Bonus, whether payable as a statutory minimum or on a sharing of surplus and Ex gratia payable in lieu of or in addition to Bonus is treated as part of the employee cost¹³.
3. **Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute is considered as part of the Employee Cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits¹⁴.**

Remuneration of Non Executive Directors will not be considered as part of Employee cost but treated as part of administrative overheads.

4. Performance Incentives must be accumulated over the entire production and not recognised after the threshold limit for earning the incentive is reached.
5. Separation costs related to voluntary retirement, retrenchment, termination etc. should be amortized over the period benefiting from such costs¹⁵.
6. Amount payable to employees during the lay off period or for the strike period or during suspension, is not included in cost.
7. Cost of employee share options is treated part of employee cost provided the same is not a notional cost and involves an actual cash outlay.
8. **Gratuity, pension and other superannuation benefits, measured using actuarial valuation method or any other methods, are part of Employee Cost.**
9. Amortized separation costs related to voluntary retirement, retrenchment, and termination etc. for the period is treated as indirect cost and assigned to the cost objects. Unamortized amount relating to discontinued operations should not be treated as employee cost¹⁶.
10. Recruitment costs, Training costs and other such costs is treated as overheads and dealt with accordingly¹⁷.
11. Overtime premium and idle time cost should be assigned directly to a cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime or idle time¹⁸.
12. Where the employee service is directly traceable to a Cost object, such cost is assigned on the basis of time consumed¹⁹.
13. When employee costs are not directly traceable to a Cost object, they are assigned on a suitable basis like estimates of time based on time study²⁰.

12 CAS 7 Paragraph 5.1

13 CAS 7 Paragraph 5.2

14 CAS 7 Paragraph 5.3

15 CAS 7 Paragraph 5.4

16 CAS 7 Paragraph 6.4

17 CAS 7 Paragraph 6.5

18 CAS 7 Paragraph 6.6, 6.7

19 CAS 7 Paragraph 6.1

20 CAS 7 Paragraph 6.3

DIRECT EXPENSES

1. **The identification of Direct Expenses is based on traceability in an economically feasible manner²¹.**

Many expenses in real life may be capable of identified as Direct Expenses but often they are grouped as overheads because it is not economically feasible to trace them to cost objects.

2. **Similarly if an item of the expense does not meet the test of materiality, it can be treated as part of overheads²².**
3. **Expenses incurred for the use of bought out resources are determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited²³.**
4. **Other Direct Expenses other than those referred above are determined on the basis of amount incurred in connection therewith²⁴.**
5. **Expenses paid or incurred in lump sum or which is in the nature of 'one-time' payment, is amortized on the basis of the estimated output or benefit to be derived from such expenses²⁵.**
6. **Direct Expenses are by definition directly traceable to cost objects and hence no special principles are involved for them to be assigned to cost object²⁶.**

UTILITIES

1. **The cost of utilities purchased is measured at cost of purchase including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited²⁷.**

This is subject to the usual condition that it can be quantified with reasonable accuracy at the time of acquisition.

2. **The cost of generated utilities includes direct materials, direct labour, direct expenses and factory overheads²⁸.**
Example of Direct materials for utilities is fuel used in generation of power and for Direct Expenses, electricity tax for generation.
3. **Cost of Utilities generated for the purpose of inter unit transfers is arrived as Cost of self generated utilities with Distribution cost added²⁹.**
4. **Cost of Utilities generated for Intercompany transfer is arrived as Cost of self generated utilities plus Distribution cost plus share of administrative overheads³⁰.**
5. **Cost of Utilities generated for sale to outside parties is arrived as Cost of self generated utilities plus Distribution cost plus share of administrative overheads plus marketing overheads³¹.**
6. **The Cost of Utilities includes Cost of distribution of such utilities³².**

21 CAS 10 Paragraph 5.1

22 CAS 10 Paragraph 5.2.3

23 CAS 10 Paragraph 5.2.1

24 CAS 10 Paragraph 5.2.2

25 CAS 10 Paragraph 5.3

26 CAS 10 Paragraph 6.1

27 CAS 8 Paragraph 5.2

28 CAS 8 Paragraph 5.3.1

29 CAS 8 Paragraph 5.3.2

30 CAS 8 Paragraph 5.3.3

31 CAS 8 Paragraph 5.3.4

32 CAS 8 Paragraph 5.3.4



7. Cost of production and distribution of utilities is determined based on the normal or actual capacity whichever is higher and unabsorbed cost, if any, is treated as abnormal cost³³.
8. Cost of stand by utility includes the committed costs of maintaining such utility³⁴.
9. While assigning cost of utilities, traceability to a cost object in an economically feasible manner is the guiding principle³⁵.

Accurate recording of utilities consumed by various users' calls for significant investment in measuring instruments and manpower for recording and analysis of such metered data. The benefit from such expenditure needs to be justified.
10. The most appropriate basis for distribution of cost of a utility to the departments consuming services is to be derived from usage parameters³⁶.

REPAIRS AND MAINTENANCE COST

1. The cost of Repairs and Maintenance is the aggregate of direct and indirect cost relating to repairs and maintenance activity³⁷.
2. Cost of in-house Repairs and Maintenance activity will include cost of materials, consumable stores, spares, manpower, equipment usage, utilities and other resources used in the activity³⁸.
3. Cost of Repairs and Maintenance activity carried out by outside contractors inside the entity will include the charges payable to the contractor apart from the above in-house cost³⁹.
4. Cost of Repairs and Maintenance activity carried out by contractors at his premises is determined at invoice or agreed price including duties and taxes and other expenditure directly attributable net of discounts (other than cash discount), taxes and duties refundable or to be credited. It will also include the cost of other resources provided to the contractors⁴⁰.
5. **Each type of Repairs and Maintenance is treated as a distinct activity, if material and identifiable**⁴¹.
6. The cost is measured for each major asset category separately⁴².
7. **Cost of spares replaced which do not enhance the future economic benefits of the existing asset beyond its previously assessed standard of performance is included under Repairs and Maintenance cost**⁴³, when Repairs and Maintenance is considered as a separate cost centre, the cost of which is apportioned to user centres.
8. **Where a high value spare is replaced, and the replaced spare is reconditioned and such spare is expected to result in future economic benefits, it is taken into stock. Such a spare is valued at an amount that measures its service potential in relation to a new spare, the amount of which will not exceed the cost of reconditioning the spare. The difference between the total of the cost of the new spare and the reconditioning cost and the value of the reconditioned spare should be treated as Repairs and Maintenance cost**⁴⁴.

33 CAS 8 Paragraph 5.9

34 CAS 8 Paragraph 5.9

35 CAS 8 Paragraph 6.1

36 CAS 8 Paragraph 6.3

37 CAS 12 Paragraph 5.1

38 CAS 12 Paragraph 5.2

39 CAS 12 Paragraph 5.3

40 CAS 12 Paragraph 5.4

41 CAS 12 Paragraph 5.6.1

42 CAS 12 Paragraph 5.6.2

43 CAS 12 Paragraph 5.7

44 CAS 12 Paragraph 5.8

9. Cost of major overhaul is amortized on a rational basis⁴⁵.

Major overhaul is the periodic (generally more than one year) repair work carried out to substantially restore the asset to the intended working condition.

10. Repairs and Maintenance cost is traced to a cost object to the extent economically feasible⁴⁶.

11. Where the Repairs and Maintenance cost is not directly traceable, it is assigned based on either of the principles of Cause and Effect or Benefits Received⁴⁷.

PRODUCTION OVERHEADS

1. Overheads comprise of indirect material cost, indirect employee cost and indirect expenses. They are termed indirect because they are not directly identifiable or allocable to the ultimate cost object – usually a product or service – in an economically feasible way.

2. **Production Overheads are indirect costs involved in the production process or in rendering services.** Production Overheads include **administration cost relating to production, factory, works or manufacturing.** Production related expenses incurred at corporate office, e.g. design office expenses, materials management and industrial relations will also be covered by the term⁴⁸.

3. The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably⁴⁹.

4. Since overheads cannot be economically traced to products and services, they are assigned to them on some equitable basis.

5. **While assigning overheads, traceability to a cost object in an economically feasible manner shall be the guiding principle. The cost which can be traced directly to a cost object shall be directly assigned⁵⁰.**

6. **Assignment of overheads to the cost objects shall be based on either of the following two principles;**

(i) **Cause and Effect – Cause is the process or operation or activity and effect is the incurrence of cost.**

(ii) **Benefits Received –Overheads are to be apportioned to the various cost objects in proportion to the benefits received by them⁵¹.**

7. **Secondary assignment of overheads may be done by following either Reciprocal Basis or Non-Reciprocal Basis. While reciprocal basis considers the exchange of service among the service departments, non-reciprocal basis considers only one directional service flow from a service cost centre to other production cost(s)⁵².**

8. **It is not a good practice to allocate overheads to Cost Centres/ Cost Objects on the basis of “what the traffic will bear” – that is by size of the user.**

9. **There is a distinct preference for allocating overheads on the basis of “cause and effect” analysis. What or who causes the costs to be incurred is a more rational criterion to assign costs rather than size or benefits received.**

45 CAS 12 Paragraph 5.9

46 CAS 12 Paragraph 6.1

47 CAS 12 Paragraph 6.2

48 CAS 13 Paragraph 4.9

49 CAS 13 Paragraph 4.2

50 CAS 3 (R-1) Paragraph 6.1

51 CAS 3 (R-1) Paragraph 6.2

52 CAS 3 (R-1) Paragraph 6.3.2



10. **In case of facilities created on a standby or ready to serve basis, the cost shall be assigned on the basis of expected benefits instead of actual.**
11. Production Overheads are usually accumulated under production cost centres to facilitate absorption by products or services.
12. These costs are absorbed by the products on the basis of resources used by the product at the production centre.
13. The overheads assigned to the production cost centres are charged to products/ services through an overhead absorption rate for each cost centre.

Common bases for assignment of Production overheads to Cost Objects are:

<i>Bases of denominator</i>	<i>Applicability</i>
<i>Unit of Production</i>	<i>When single product is produced or various products are similar in specifications.</i>
<i>Material Cost</i>	<i>Where the overheads are mostly related to material.</i>
<i>Direct employee cost</i>	<i>When conversion process is labour intensive and wage rates are substantially uniform</i>
<i>Direct employee hour</i>	<i>When conversion process is labour intensive</i>
<i>Machine Hour or Vessel Occupancy or Reaction Hour or Crushing Hour etc.</i>	<i>When production mainly depends on performance of the base</i>

A preferred approach for assignment of overheads to cost objects is to use multiple drivers instead of a single driver such as machine hour, where feasible⁵³.

14. A preferred approach to assignment of overheads is the assigning of cost of resources to activities and assigning the cost of activities to Cost Objects through use of cost drivers, wherever feasible⁵⁴.
15. Also there are service cost centres through which the product does not pass through but which provide a support function to the production cost centres.
16. Where the cost of services rendered by a service cost centre is not directly traceable to a cost object, it shall be assigned on the most appropriate basis⁵⁵.
17. The most appropriate basis of distribution of cost of a service cost centre to the cost centres consuming services is to be derived from logical parameters which could be related to the usage of the service rendered. The parameter shall be equitable, reasonable and consistent⁵⁶.
18. **Charging overheads on the basis of "benefits received" by the various users is preferred. This requires some measure of "receipt of benefit" to be developed.**
19. Sometimes capacity in a service department is created in anticipation of demand for services. It is appropriate to allocate such capacity costs on the basis of "capacity to serve" rather than actual usage of services.

Ultimately all overheads must be charged to products of services. Hence the total production overheads of Production Cost Centres are applied to products passing through them using a suitable absorption base.

20. **Before the final step of absorption, production overheads of production cost centres have to be segregated between fixed overheads and variable overheads. The fixed overheads are absorbed by products based on normal capacity or actual capacity utilization whichever is higher. Variable overheads are absorbed by products based on actual capacity utilization. This treatment is in line with Accounting Standard 2 as well.**

53 CAS 3 (R-1) Paragraph 6.4

54 CAS 3 (R-1) Paragraph 6.5

55 CAS 3 (R-1) Paragraph 6.2

56 CAS 3 (R-1) Paragraph 6.3

21. **Normal capacity is defined in Cost Accounting Standard 2 as the production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance. It is practical capacity minus the loss of productive capacity due to external factors⁵⁷.**
22. **Under-absorbed fixed overheads are charged off to Costing Profit & Loss Account and shown as an item of Reconciliation with financial accounts.**

DEPRECIATION

1. Depreciation, though part of overheads, generally appears as a separate line item in the cost statements instead of being grouped under overheads. This is because of its size in the technology driven business of today and its unique characteristic of being non-cash cost.
2. Amortization of intangible assets tends to be grouped with depreciation because intangible assets themselves are grouped with Fixed Assets in the presentation under Schedule III of the Companies Act 2013.
3. The measurement of depreciation in Cost accounts tends to mirror the practices in financial accounts.
4. However the treatment of depreciation in Cost Accounts must address the following issues:
 - Depreciation not calculated on period of use basis.
 - Depreciation on idle assets
 - 100% of depreciation on certain class of assets
 - Write-off of small value assets
 - Depreciation on fully depreciated assets
 - Depreciation on revalued assets
5. Sometimes depreciation in books is not calculated on period of use, for example 50% of annual depreciation is taken for an asset put into use for a day in financial accounts keeping in mind Income Tax provisions. **Cost accounts will always use the depreciation computed on period of use basis and take the balance to Costing P & L or reconciliation with financial accounts.**
6. Even where 100% of the depreciation is allowed in the first year for income tax purposes, companies are required to use regular rates of depreciation for cost accounting purposes. Even where an entity uses 100% depreciation rates in financial books of accounts, **depreciation based on estimated life is used for costing purposes with the difference taken to costing Profit & Loss or Reconciliation with Financial Accounts.**
7. **Where small value items are written off fully at the time of purchase in financial accounts, the same is generally adopted for cost accounts.**
8. **In the case of old plants, there is the special case for fully depreciated assets which however continue in regular service. Some entities continue to provide a notional depreciation on such assets for decision making purposes.**
9. Depreciation on the amount by which the asset is written up on Revaluation is charged to Revaluation Reserve in financial books. **Some entities compute the depreciation on the revalued figure for costing purposes to reflect the true cost of depreciation.**

⁵⁷ CAS 2 Paragraph 4.4



10. **It goes without saying that the cumulative depreciation charged in the Cost Accounts against any individual item of fixed asset will not exceed the original cost of the asset.**
11. The assignment of depreciation to various cost centres should not pose a problem so long as detailed Fixed Asset records are maintained by the Company. However there are some common items of fixed assets between cost centres e.g. yard piping carrying products from one process to another, common storage tanks and the like. **Depreciation on common assets are apportioned to individual cost centre on some suitable basis e.g. yard piping is assigned to the cost centre receiving the material.**

ADMINISTRATIVE OVERHEADS

1. **Administrative overheads are the aggregate cost of resources consumed in activities relating to general management and administration of an organisation⁵⁸.**

The principles of measurement of Material Cost, Employee Cost, Utilities, Repairs & Maintenance and Depreciation found in the respective standards will apply if included in administrative overheads.

2. **In case of leased assets, if it is an operating lease – the entire rentals will be treated as a part of administrative overheads, while in case of a financial lease – the finance cost portion will be segregated and treated as a part of finance cost⁵⁹.**
3. **The cost of software (developed in house, purchased, licensed or customized), including up-gradation should be amortized over its useful life⁶⁰.**

When hardware requires up-gradation along with the software, it is recommended to use compatible estimated lives for the two sets of cost.

4. **The cost of the administrative services procured from outside is determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable net of discounts (other than cash discount), taxes and duties refundable or to be credited⁶¹. The assignment of administrative overheads to cost objects is based on either of the principles of Cause and Effect or Benefits received, if it is not directly traceable⁶².**

The cost of shared services is best assigned to user activities on the basis of actual usage, infrastructure costs on the basis of readiness to serve and general management costs on a rational basis. For e.g.: Number of employees, turnover, investment size etc.

5. Since most administrative costs are fixed in nature, it is preferable to charge them to users on "readiness to serve" basis such as installed capacity, budgeted sales etc. rather than actual production or actual sales. Even the drivers mentioned in (9) above can be on the basis of expected driver qualities rather than actual.

SELLING AND DISTRIBUTION OVERHEADS

1. Selling costs can be recorded in a manner which will facilitate customer / product profitability analysis, as appropriate. Thus selling costs can be identified to markets, distribution channels, territories, salesman etc., before being assigned to customer / product as applicable.
2. **The acceptable bases for apportionment of common selling costs to customers / products are:**
 - a. **Weight**
 - b. **Units / equivalent units**

⁵⁸ CAS 11 Paragraph 5.1

⁵⁹ CAS 11 Paragraph 5.2

⁶⁰ CAS 11 Paragraph 5.3

⁶¹ CAS 11 Paragraph 5.4

⁶² CAS 11 Paragraph 6.2

- c. Value of goods
 - d. Any other appropriate and equitable basis
3. The acceptable bases for assigning common transport costs to products are:
- a. Weight
 - b. Volume of goods
 - c. Tonne km
 - d. Units / equivalent units
 - e. Value of goods
4. The transportation costs assigned to products are charged to units based on some measure which factors in the distance e.g. tonne km.

INTEREST AND FINANCE CHARGES

1. Interest and Finance Charges have come to be included in cost of sales though not in cost of production. Such costs are also assigned to products before arriving at margins by product.
2. For the purpose of assignment, Interest charges are grouped under
 - interest on long term funds
 - interest on working capital funds
3. **The former is assigned to product lines based on fixed capital investment (including fixed assets and mould and dies) in such product lines. A portion of the interest is also charged to outside investments, if they exist, and excluded from cost of sales. For this purpose, it is usual to develop an average cost of long term funds and apply it to fixed capital investment in each product line.**
4. It is not the accepted practice to charge imputed interest on owners' funds in cost accounting.

SALES

1. Cost of sales statements lead right up to margin and hence sales also have to be handled in Cost Accounting.
2. **Since costing is always by product, cost accounting requires product wise analysis of sales.** This is usually produced by other modules of the enterprise system.
3. What is critical is the value of sales produced by such analysis. Often sales analysis produce invoiced value of sales. **What is required for cost accounting is net value of sales net of trade discounts, returns, allowances, volume discounts, special discounts based on market conditions etc.**
4. Many of these deductions from sales are transacted through credit notes which also must be processed through the sales analysis to arrive at product wise break up.
5. **Some of these deductions from sales may be available only in total and hence may have to be allocated to products on a suitable basis, say, sales value.**
6. It is not unusual for businesses to focus on net realization from sales ex-factory gate. This means that freight (both primary and secondary), transit insurance, loading and unloading charges, handling charges and the like are deducted from net sales as arrived at in 3 above to arrive at net sales realization ex-factory gate. This also entails freight and other transport costs not being shown under the head Distribution costs. So long as these costs are shown separately as deductions from net sales value, the practice is acceptable.
7. Companies (Cost Records and Audit) Rules, 2014 require gross sales to be shown in addition to net sales in cost statement. This requires that excise duty, sales tax (VAT) etc is added to net sales to arrive at gross sales by product.



JOINT COSTS

1. Joint Costs are the costs of a production process that yields multiple products simultaneously, for example, in the refining of Petroleum which yields Petrol, Kerosene, Diesel, Naphta, Grease, Tar and several other products or the distillation of coal, which yields coke, natural gas, and other products.
2. The costs of the common process are the joint costs.
3. **Joint costs are allocated**
 - (a) Based on a measure of the number of units, weight, or volume of the joint products, or
 - (b) Based on the values attributed to the joint products.
4. By-product is a special case of Joint Product where one or more of the joint product has minor value compared to others.
5. **Such by-products are generally valued at their value at the split-off point with such value being credited to the costs of the main product. The split-off point value is arrived at on the basis of the ultimate realizable value of the by-product less the post split-off costs.**

COMMON COSTS

1. A common cost is the cost of operating a common facility, activity or service or that is shared by two or more cost objects.
2. The common cost is generally lower than the stand-alone individual cost to each cost object was the facility not shared.
3. **Common costs are therefore allocated to each cost object based on the individual costs of the cost object.**

8. Presentation and Disclosure

Generally the presentation requirements of cost information for statutory purposes are laid down in the respective rules. Similarly the requirements of reporting for regulatory purposes are laid down by the regulatory agencies. Managements stipulate the presentation formats for managerial purposes. It is therefore not considered necessary to lay down any model statements or formats in this document.

However it is considered appropriate to stress certain disclosure practices which are generally applicable.

1. Cost Statements must contain, besides total cost, unit cost per unit of output.
2. Output quantities with unit of measure must appear in the Cost Statements.
3. Input costs are best broken up as quantity and rate.
4. The basis of valuation of inputs must be stated.
5. The basis of distribution of costs to cost objects or cost centres must be disclosed.
6. Costs incurred in foreign currency must be stated separately.
7. Any costs excluded must be disclosed.
8. Any credits or recoveries netted against cost must be disclosed separately.
9. Transactions with related parties must be highlighted or disclosed separately.
10. Cost elements, which are material for a product or activity, must be disclosed separately.
11. Cost details of all ancillary products or activities may be maintained under a miscellaneous group and disclosed appropriately.
12. Changes in the costing principles and methods applied must be disclosed with the effect.

9. Conclusion

This document contains a discussion of the generally accepted cost accounting principles in the context of today and the times gone by. It must be understood that cost accounting principles and methods of applying them are in a constant flux influenced by fresh thinking by experts, regulatory influences, parallel developments in financial accounting standards and the like. Professional accountants will be well advised to use this document as a guide and not as a set of rules.

Appendix I

APPLICATION GUIDANCE

Material Cost

1. Under the erstwhile Companies (Cost Records and Audit) Rules, 2014 the Cost of purchased materials is reckoned inclusive of all "direct charges up to works". The term "works" can be taken to mean any place of operations.
2. The direct charges include in the case of indigenous materials, the invoice cost, freight, transit insurance, loading and unloading charges. In the case of imported materials, they include FOB value, overseas freight, insurance, customs duty, clearing charges, inland freight etc.
3. Demurrage or detention charges at port or by carrier or penalty levied by them are not treated as cost, being abnormal cost.
4. Penalties levied by tax authorities such as customs, excise sales tax authorities on consignments of goods are not treated as cost.
5. Taxes for which the buyer gets credit like Vat, cenvat, countervailing import duty are excluded from Cost.
6. Purchase Tax is sometimes levied by State Governments on inputs with or without relief against tax payable on sale. Such tax is to be taken as part of cost except to the extent it is allowed to be offset against tax on sale.
7. Octroi levied by local authorities on inputs entering the local limits must be added to cost. If subsequently the goods are taken out of local limits, the amounts can be retrenched from cost.
8. The levy of additional tax for non compliance with filing declaration forms e.g. 'C' or 'D' forms under central sales tax is treated differently with the additional tax being treated as part of cost if known at the time of recording the transaction.
9. Cost is net of trade discount. Cash discount is generally treated as a financial income and not netted against cost. But there may be circumstances in a transaction which suggest that the cash discount is not a prompt payment discount but a price discount offered in the garb of a cash discount.
10. Cost is to be taken net of Volume discounts to the extent these can be anticipated. Where there is uncertainty regarding the eligibility or the quantum, these may be netted against consumption as when they become confirmed.
11. Bank charges for negotiation of documents in connection with a purchase transaction are generally treated as finance costs and not included in material cost. This is based on the premise that sale documents are negotiated through bank to avoid credit risks or to avail bank finance. Hence Bank Charges on bills negotiated through bank on collection or acceptance basis are often added to material cost but are best excluded from material cost. Interest, when charged by the supplier for the whole or part of the credit period extended, is generally treated as a finance charge. This is so even if the interest appears on the face of the invoice.
12. Imports of materials from certain countries are often available with extended periods of credit with zero or concessional rate of interest. Whether the concession in the matter of interest should be treated as cost is unsettled.
13. Exchange losses or gains incurred after the purchase transaction is completed is not treated as material cost but is to be treated as finance cost.



14. In some industries, the material purchased is the output of mining or quarrying operations from owned mines or quarries. For example, limestone which is a key raw material is obtained by a cement mill from its own mines. The cost of material mines is determined by taking into account royalty to government, cost of explosives used, and mining costs. The question of principle that arises is the treatment of mines development costs which occur regularly over the years. The cost of mines development is treated as cost of mining the output of the current year but there is much in favour of spreading the development costs over the period over based on a development to run-of-the mines ratio.
15. The cost of materials obtained in returnable containers where there is a credit on return is taken net of the credit. Where rent is payable for the period for which the container is retained, such rent is treated as overheads.
16. The rate to be adopted for a material in cost accounting is generally taken after adjusting material losses- in transit, in storage or other losses. This is however permissible only if the losses are normal. Transit losses can be reflected in the rate by deducting such losses from the billed quantity provided such losses are incidental to transport. The percentage of such normal losses can be quite high for some materials e.g. coal.
17. Apart from physical loss, there can be losses due to evaporation or shrinkage. They are also treated in the same way.
18. An abnormal loss in transit e.g. loss due to accident cannot be reflected in the rate. It will be treated as a loss and taken to Profit or Loss net of recoveries from insurance, or carrier.
19. Storage losses are also treated similarly provided they are incidental to storage and the period of storage is normal in the given case.
20. On a slightly different footing are moisture losses in transit or storage. Since most technical calculations are based on dry weight, it is advisable to account for materials which absorb moisture on a dry weight basis grossing up the rate. Dry weight can be air-dry or bone dry. In the case of wood used in paper industry, given that wood contains some moisture, the rate for wood is accounted on the basis of Air Dry weight which may be obtained after deducting standard or average moisture contents of such wood. Alternatively it can be accounted on bone-dry weight after deducting the entire moisture on actual basis.
21. Similar adjustments are called for when consumption quantities of materials in cost accounting are to be aligned with technical calculations which adjust physical quantities for strength, purity or other factors. In these cases also, the rates are grossed up to reflect quantity restatements.
22. Exchange losses or gains incurred after the purchase transaction is completed is not treated as material cost but is to be treated as finance cost.
23. Sometimes, materials are sent outside for pre-processing before it is used in the production process, e.g. cotton for ginning / cleaning, steel rods for blanking etc. Charges paid to outsiders for pre-processing are added to material cost.
24. If the same operations are performed in-house, it is usual to treat them as production cost and not as part of material cost.
25. Material is often held for long periods for seasoning, maturing etc. The storage and interest cost for such storage is treated as part of material cost.
26. Some materials may require special storage facilities e.g. prawns in freezers. A cost of such special storage is often treated as part of material costs.
27. Materials may undergo discolouration, deterioration in quality or outline the shelf-life. Losses for such reasons are not treated as part of material cost.
28. Amount of recovery from disposable containers in which material is received is best treated as miscellaneous income and not reduced from material cost.

29. The treatment in the case of returnable containers where credit is obtained from the supplier on a regular basis can be different. Such credit is generally reduced from material cost. Where the container cost is not included in the price charged but a charge is made for non-return or late return, such charge is treated as abnormal cost and excluded from cost.
30. When material is supplied in returnable containers and a rent is charged for such container based on the period of use, the cost is treated as overheads.
31. Material is often held in storage under special conditions e.g. LSHS at higher than ambient temperature to prevent solidifying, the associated costs are not treated as part of material costs but as part of production costs.
32. The costs of operating and maintaining pipe lines for moving materials from storage to production are not treated as part of material costs but as part of production costs. So also the pumping charges for liquids. The feeding charge for materials to equipment at an elevated level is also treated as production costs.
33. Any Subsidy / Grant / Incentive and any such payment received / receivable with respect to the input cost is reduced from the cost of the cost object to which such amount pertains. In case of any subsidy / grant received / receivable with respect to price of the product is to be treated as income and not reduced from the cost of the cost object.

EMPLOYEE COSTS

1. Employee Cost or Labour cost includes all remuneration paid to employees of the company including allowances, benefits or any payment made in behalf of employees.
2. Employee cost includes remuneration paid or payable and provisions made for future payments.
3. For cost accounting purposes, employee cost includes amounts paid to temporary, part time and casual or contract employees including benefits extended to them.
4. Bonus has been described by courts as "deferred wage" and customary payments by way of bonus have come to acquire the characteristic of mandatory payment. There is little reason to deny such payments the status of cost.
5. Ex-gratia payments are after often paid along with statutory bonus. These may take the form of;
 - a. Amount paid as a rate higher than the rate arrived at as per Payment of Bonus Act calculations.
 - b. Extending full rate of bonus to those to whom the maximum bonus under the Payment of Bonus Act will apply- presently limited to ₹ 8500/- per month by way of Basic + DA.
 - c. Extending the bonus to employees not covered under the Payment of Bonus Act – presently ₹10000/- per month or more by way of Basic + DA.
 - d. These payments which are in the nature of goodwill payment by managements and are in no way related to the amount of allocable surplus are generally treated as part of employee cost.
6. Bonus under the Payment of Bonus Act must be distinguished from performance incentives which are generally related to output and not profits. These may take the form of incentives at;
 - Individual employee level – based on his or her performance.
 - Group of employees level – based on performance of a group of employees or team
 - Unit level – where the incentives are paid on the basis of performance of the factory or other unit.

Incentives at all three levels may be based on performance covering the production of more than one product; then an assignment issue arises. It is generally accepted that the incentives have to be prorated over all the products on the production of which the incentive is earned, not merely to the products produced after the threshold limit for earning the incentive is reached.



7. There has been generally a reluctance to treat incentives based on sales as cost of production, even though it is paid to production employees. The basis for calculating the incentive or the timing of payment should not determine the treatment of such incentive. The fact that such payment is computed on sales value of production or is payable only on sales of the product cannot change the character of an incentive – if it was originally conceived as an incentive for higher production.
8. Some will argue that managerial personnel are owners of the business and hence the payment to them must be regarded as return to owners. Others will argue that the remuneration to managerial personnel is as executive directors, manager etc and hence must be regarded as cost. The latter view gets higher credence with greater professionalization of management and whole-time Directors with no or little shareholding in the company drawing managerial remuneration which includes a commission as a % of profits.
9. In the case of sole proprietorships, salary paid to owner and in the case of a partnership fixed salary paid to a working partner must qualify as cost.
10. It is customary for senior management to be extended perquisites in the form of free housing, free car, services of waterman / gardener, free telephone, leave travel concession for self and family.
11. The Income-Tax rules provide for the valuation of these perquisites. But these cannot in anyway enter into cost calculations. Employee cost includes the cost to company of extending these benefits. The cost to company (CTC) calculations made at the time of appointment or later is a good guide on what should enter into employee cost. The fact that some portion of the perquisites is disallowed in the assessment of the employee as being personal in nature can not influence the treatment in cost accounts.
12. There are group benefits extended to employees such as Group Personal Accident Insurance, Group Medical Insurance Scheme etc. It is difficult to relate such costs to individual employees and therefore to cost centres or objects. These can only be allocated to cost centres or cost objects on the basis of number of employees or employee cost of each cost centre or cost object.
13. Employee welfare expenses similarly represent motley of benefits including canteen facilities, recreation facilities, gifts to individual employees on birthdays / marriage, dispensary facilities etc. These are legitimately treated as part of employee cost and allocated to cost centres or cost objects on the basis of no. of employees or employee cost of each centre or cost object.
14. Post-employment benefit schemes can take any two forms;
 - a. Fixed contribution to a fund by the employer with varying benefits to employees.
 - b. Variable contribution to a fund by the employer to assure given benefit to the employees.
 - c. The fixed contribution plans involves a defined cost per employee and can be readily assigned to cost centres or objects. The contribution under variable contribution plans are generally determined on an actuarial valuation The treatment of such benefits in Cost Accounts will be on the same basis as in financial accounts which is governed by AS-15 in India.
 - d. The allocation of the cost of such employee benefits to cost centres / Cost objects will be on the basis of no. of employees or employee cost.
15. Voluntary retirement plan costs have been treated in varying ways in India. The treatment of the same will be as per Cost Accounting Standard 7.
16. It is usual for employee cost, particularly direct employee cost, to be converted to hourly rates for ease of assignment to jobs or products. Such hourly rate may reflect only payroll costs i.e., only basic + dearness allowance + allowances or be comprehensive and include all benefits. The ultimate is for the rate to reflect the Cost to Company (CTC). Where the rate excludes some elements of employee cost, these will be treated as overheads and absorbed in cost.
17. Hourly rates are arrived at using the available hours as the divisor. Normal health breaks or rest allowances are excluded from available hours. It is important to note that any time like rest time which gets included in job times cannot be excluded from available hours.

18. It is not unusual for regular costing to proceed on the basis of standard hourly rates based on budgeted employee cost and budgeted hours and for the variances in labour rates to be treated as overheads or taken to costing P&L or reconciliation.
19. Labour cost falls into two categories;
 - Direct Employee cost
 - Indirect Employee cost
20. Early stages of technology witnessed a major role for the workmen in the manufacturing process with output being controlled mainly by the workmen's efforts. Hence elaborate systems were built to log workmen's time on individual jobs or products and operations and employee cost was assigned on the basis of seven time booking.
21. As technology grew, the importance of machines in production grew with decreasing nexus between workmen's efforts and production. Work men were assigned to more than one machine producing more than one product with his role being reduced to attending to controls.
22. Where technology is at an early stage, it is still common for direct employee cost to be assigned to products and operations on the basis of time booked. This is typical of engineering shops with conventional machines such as lathes, drilling machines, milling machines etc., and simple processing shops.
23. Where sophisticated technology is deployed such as computer numerically controlled machines are employed, it is usual for employee cost to be absorbed in products as part of a comprehensive machine hour rate.
24. Where a gang of workmen or a team of employees are assigned to a job, it is usual to assign direct employee cost on the basis of gang hours or time logged by the team.
25. The wheel turns a full circle when assembly operations are controlled in the main by robots and one or two work men control the whole assembly line only to attend to disruptions. Direct employee cost even the entire cost including equipment cost – in such cases is assigned on the time honoured direct labour hour basis.
26. In a balanced production line in a lean manufacturing set-up where workmen stand in fixed location, the belt carrying the work moves at fixed speed and work men are expected to complete their operations within the allotted time. In such cases, it is usual to charge employee cost as well as equipment cost on the basis of "Cycle Time" rather than labour hours.
27. Overtime which is based on single rate poses no special issues in costing. But where overtime is compensated at double or triple rate, the overtime premium is handled in one of the following ways;
 - Where the overtime working is caused by a "rush order" of the customer or other special requirement of a job, the premium is assigned to the job or product.
 - In all other cases, it is usual to treat the premium as overheads and absorb the same as part of overheads.
28. Idle time of direct workmen is generally logged separately. Normal idle time is absorbed in product cost as part of overheads and abnormal idle time is taken to costing profit and loss or reconciliation.
29. Where direct workmen are expected to carry out maintenance on the machines attended by them, it is usual to log such time separately against maintenance work orders and treat the same as Repairs and Maintenance Cost.
30. Booking of time spent on jobs or products is relevant in job or batch operations but loses its relevance in continuous process industries where direct employee cost is treated as part of processing cost.
31. Changing direct employee cost on the basis of standard time is prevalent. In such cases, the efficiency variance is isolated and absorbed in product cost except where it is abnormal, where it is taken to costing P&L or reconciliation.



DIRECT EXPENSES

1. Direct expenses are those relating to manufacture of a product or rendering a service, which can be readily identified or linked with cost objects other than Direct Material and Direct Employee cost.
2. Examples are:
 - a. Royalties charged on production,
 - b. Job charges,
 - c. Hire charges for use of specific equipment for a specific job,
 - d. Cost of special designs or drawings for a job,
 - e. Software services specifically required for a job,
 - f. Travelling Expenses for a specific job.
3. The need for direct expenses to be amortised arises when for example Royalty or Technical know-how fees, or drawing designing fees, are paid for which the benefit accrues in the future period. In such case, the production / service volumes are estimated for the effective period and based on volume achieved during the current period, the charge for amortisation is determined.

COST OF UTILITIES

1. Utilities are a special class of service cost centres which generally produce a measurable output which are used as inputs in the process of manufacture of products and services but do not form of the products. Examples are power, steam, water (treated, demineralised etc.) compressed air and the like.
2. Utilities are generally meant for captive consumption even though it is not unusual for part of the output to be sold to a nearby plant of the same entity or another entity.
3. Utilities are also purchased by an entity from an outside source usually a public utility (e.g. power from an electricity authority) or steam from neighbouring plant.
4. It is also not usual for utilities produced to have more than one use – steam generated being used both to drive turbines to generate electricity (high pressure steam) and also for heating purposes in the process (low pressure steam) giving rise to interesting issues in costing.
5. Sometimes a utility is held to safeguard against the failure of the main source of input of the utility e.g., stand-by generators held against failure of power supply from the grid.
6. Administrative overheads are generally not allocated to captively used utilities. Where the utilities are largely meant for transfer to other units or sale to outside parties such as sale of generated power to the official grid, administrative overheads may also be allocated to the utilities.
7. Since the cost of utilities is significant in many entities and there is a measurable output, it is usual to do the costing of utilities with the same rigour as in the case of products and services. The Companies (Cost Records and Audit) Rules, 2014 require the preparation of separate cost statements for each major utility such as power, steam and the like. The Cost Accounting Standard 8 on Cost of Utilities requires each type of utility to be treated as a separate cost object.
8. Costs of distributing the utilities e.g. power through distribution lines including transformers, motor control centres and the like are treated differently based on end use. Costs of distribution of utilities for captive use are often captured in a separate service cost centre and treated as a service cost centre. Cost of utilities used for inter unit transfer often include the proportionate cost of distribution.
9. Costs of utilities meant for sale to outside parties will include marketing costs if the generated utility is mainly meant for sale but this takes the context out of captive generation and consumption of utilities in the manufacture of products and rendering of services.

10. Where part of the utility generated is used within the utility e.g. electricity used within the power house, cost of such consumption is generally absorbed by the cost of output meant for other users. This has got the effect of grossing up the unit cost of the utility for the costs of internal consumption of the respective utilities.
11. Output of utilities is generally distinguished in terms of quality. In the case of water, raising of water from bore wells or pumped from a nearby river is identified as raw water, whereas the output of a Water Treatment Plant is identified as treated water; the output from a cooling tower as cooling water; and the output from a chilling plant as chilled water. Similarly steam produced is classified as low pressure, medium pressure or high pressure or into bands of pressure rating.
12. Costs of generation of various types of water involve progressively additional costs while costs of steam generation have to be allocated to steam at different pressures based on some measure of work for e.g. British Thermal Units (BTUs)
13. The use of by-products from the manufacturing process as fuel in utilities e.g. bagasse as fuel in the boiler calls for special treatment. These by-products are evaluated on the basis of their calorific value in relation to the principal fuel used by the entity e.g. coal. If the by-product is the only fuel used by the entity, it is evaluated on the basis of its calorific value in relation to alternate fuels that can be used by the entity. In other cases, the market value of such by-product, e.g. price of bagasse in open market sales, can be used for valuing the by-product.
14. Sometimes, waste material recovered from input materials may be used as fuels in the utilities, e.g. pith from bagasse or bark from wood used as raw material in a paper mill.
15. The methods of assignment of costs of generated utilities to the consuming centres vary considerably depending on the system of measurement of usage, e.g. metering, instrumentation system and the like used in the entity. It may be safely said that it may be uneconomical to meter the consumption of utilities to the last unit. Some technical estimates may have to be used. The problem is complicated because distribution lines are not always laid out in such a way that measuring instruments can be installed at each distribution point. It is not uncommon to tap power from a nearby line carrying power to another consuming centre or to divert steam from a nearby pipe carrying steam to another consuming centre. These problems get accentuated as the plant advances in years when new requirements of utilities are met in an adhoc manner such that the original drawings of distribution lines are no longer representative.
16. Wherever meters are installed, utility costs are assigned on the basis of actual usage as metered.
17. Alternatively, utility costs are assigned on the basis of ratings of consuming equipment weighted by a usage factor, e.g. in the case of power, based on HP rating of equipment multiplied by number of hours in use. As a last resort, technical estimates based on process specifications of power or steam consumed are used to develop the bases for allocation.
18. Distribution losses or unaccounted consumption of utilities are netted against the generated quantity before assignment to consuming cost centres so as to reflect such cost in grossed-up unit rates.
19. Any abnormal losses like venting of large quantities of high pressure steam to avoid an accident will of course be evaluated separately and treated as loss in the costing Profit & Loss or the Reconciliation with financial accounts.

REPAIRS AND MAINTENANCE COST

1. Repairs and Maintenance cost is the cost of all activities required to restore the asset to a condition to perform its function at intended capacity and efficiency.
2. Repairs and Maintenance cost includes cost of;
 - a. Repair materials
 - b. Spares
 - c. Consumable stores
 - d. Manpower
 - e. Utilities
 - f. Repair equipment costs
 - g. Allocated costs from other service cost centres.



3. Repairs and Maintenance can be classified into
 - a. Preventive Maintenance
 - b. Planned Maintenance
 - c. Breakdown Maintenance
4. Preventive Maintenance costs are generally booked through standing orders which are in essence continuing work orders, all issues of material time of maintenance crew and other resources used are booked against the standing orders.
5. Alternatively Preventive Maintenance schedules carry a standard bill of materials and standard usage of maintenance crew time and other resources and these are blown up based on no. of jobs completed. Actual usage of materials, time and other resources are recorded in detail and allocated to various preventive maintenance jobs based on standard usage.
6. Planned Maintenance jobs are jobs like Annual shutdowns, periodic overhaul etc. These carry a standard bill of materials to be used for the maintenance jobs, parts to be replaced during the planned maintenance, number and skill category of maintenance crew required, heavy maintenance equipment like cranes to be used and other resources. Actual of these resources is booked against the planned maintenance jobs.
7. Break down maintenance jobs are triggered by a Fault Report which generates a work order with a number. All issues of materials, time of crew and other resources are booked against these work orders to provide cost of individual maintenance jobs.
8. In a computerized environment, robust systems are in place to open and close work orders for all types of maintenance jobs with authorizations and sign offs, standard bills of materials type and number of persons and other resources required with automatic generation of issue requisitions and requests for personnel and equipment. Costs of closed work orders are transferred to relevant accounts in the books of accounts.
9. In a non-computerized environment, there is often a tendency to keep the paperwork to a minimum while ensuring accurate costing. In such an environment, work orders are opened only for large maintenance jobs. The threshold limit is fixed in terms of time taken for the maintenance job to be completed (or shut down time) the cost of materials requisitioned, the number of crew involved, special equipment required or a combination of these. Costs are booked by work orders for the major repairs and for others, costs are booked by cost centres or equipment number.
10. It is also usual to treat the maintenance crew as fixed resources and not attempt to book their time against maintenance jobs. The allocations to cost centres are based on the principle of "readiness to serve" with the estimate of demand from various cost centres prepared at the time of manpower planning acting as the base for allocation of manpower costs.
11. Maintenance jobs often require the use of heavy equipment such as cranes, hoists etc. The costs of this maintenance equipment are accumulated by equipment number. These are charged to maintenance jobs based on recorded usage in hours or to cost centres based on estimated usage prepared at the time of planning the capital expenditure on these items of equipment.
12. Many large production facilities have a captive workshop where parts are turned, machined or otherwise repaired. These workshops also produce some spare parts. Often, the workshop is treated similar to production cost centres with job orders being opened for production jobs and work orders for repair jobs. The costs of the workshop which comprises costs of materials, labour, equipment and other resources are assigned to jobs and work orders based on some suitable basis such as labour hours.
13. It is true that maintenance jobs are increasingly being outsourced. Maintenance Labour is almost completely outsourced with only a small crew of specialized craftsman retained on the company's rolls.
14. The outsourcing may be of the entire job or may take the form of a contract for supply of labour. In the former case, bill for completed jobs are generally available and lead to accurate costing of labour for such jobs. When outsourcing takes the form of a contract for supply of labour, no time recording by jobs is generally available and only deployment by department or cost centre is available.
15. With increasing sophistication of technology, maintenance of specialized equipment is entrusted on a turnkey basis to the vendor of the equipment or other specialized maintenance outfits. This may involve costs of travel of technicians besides bill for services from the agency rendering the services. It is usual to accumulate all costs of such maintenance jobs and treat them appropriately as outlined later.

16. It is usual to have Annual Maintenance Contracts (AMC) for specialized equipment particularly electronic equipment subject to sudden failures. These take the form of only servicing or servicing with parts (comprehensive). The AMCs specify the number of routine servicing calls that will be made in a year. Where a single machine is covered by an AMC, costing becomes simple. But where a fleet of machines are covered by a single AMC, allocation of costs to cost centres can be made on the basis of number of machines in each cost centre. Where the machine in various cost centres require different levels of service or vary in cost, a suitable allocation base has to be evolved based on such differences.
17. It has been customary in the past to treat major repair jobs differently with their cost being spread over the periods benefiting from such expenditure. Increasingly such expenditure is charged to the Profit and Loss Account of the period in financial accounts, which is driven largely by tax deductibility considerations. Further, with Accounting Standard 26 on Intangible Assets coming into force, creation of Deferred Revenue Expenditure is not allowed. However in Cost Accounts, these major repair job costs may be prorated over the year(s) of benefits with appropriate disclosure in Reconciliation statements of the respective years. The treatment in cost accounts would depend on the nature and benefit accruing from such expenditure.

PRODUCTION OVERHEADS

1. Overheads comprise of indirect material, indirect labour and indirect expenses. They are termed indirect because they are not directly identifiable or allocable to the ultimate cost object, usually a product or service, in an economically feasible way. Instead of using the term 'overheads', it is more appropriate to refer to them as Indirect Costs.
2. Increasingly with the spread of information technology, more and more costs can be identified with the final cost object. Even small materials which could not be previously identified with the products in an economically feasible way can now have the issues recorded by product.
3. On the contrary, the sophistication of manufacturing technology renders workman as observers of machines working or instrument watchers or console operators instead of tending to the machine or product directly. Thus a greater part of the labour cost is becoming indirect to the product.
4. Since overheads cannot be economically traced to products, they are traced to production centres through which the product passes to be absorbed by the product generally on the basis of time spent by the product at the production centre.
5. Also there are service cost centres through which the product does not pass through but which provide a support function to the production cost centres. The service department costs are assigned to production cost centres before being traced to products and services.
6. In traditional cost systems, a cost distribution sheet is prepared to capture the expenses in the nature of overheads booked in the books of accounts and supporting records like stores records. These are then analysed by cost centres.
7. Some overheads are booked in the system by cost centres. For this purpose, many General Ledger systems have extensions to account codes to book transactions by cost centres.
8. In other cases, the overheads individually or after being grouped into homogenous groups are apportioned to cost centres on some suitable basis. The following table reproduced from Cost Accounting Standard 3 lists the commonly used bases.

Item of Cost	Basis of Apportionment
Power	- HP Rating of Machines x hours x LF
Fuel	- Consumption rate x hour
Jigs, Tools & Fixtures	- Machine hours or Man-hours
Crane Hire Charges	- Crane hours or weight of material handled
Supervisor's salary & fringe Benefits	- Number of employees
Labour Welfare cost	- Number of employees
Rent & Rates	- Floor or space area
Insurance	- Value of fixed Asset
Depreciation	- Value of fixed Asset



9. For a long time the method of apportionment used was based on "charging what the traffic will bear", i.e. the bigger the cost centre the greater the charge to it. This is actively discouraged now.
10. Charging overheads on the basis of benefits received by the various cost centres is preferred. This requires some measure of benefit to be developed.
11. After the spread of modern cost accounting concepts, particularly activity-based costing (ABC), there is a distinct preference for apportioning overheads on the basis of cause and effect analysis. What or who causes the costs to be incurred is a more rational criterion to charge costs rather than size or benefits received.
12. Thus the Purchase Department costs are best charged based on an analysis of what causes the Purchase Department to be manned and be operating at the present level. It could be the number of purchase requisitions, the no of items being ordered, the degree of inspection required by various items, the logistics requirements involved or a weighted combination of these.
13. After the overheads are allocated or apportioned to various cost centres, the costs apportioned to service cost centres are redistributed to production cost centres and other service cost centres, generally based on one of the bases described above.
14. Given the information processing capability, individual items of overheads or groups of them are taken up for redistribution.
15. Rendering of service by one or more service cost centres to other service cost centres or even rendering of services inter se by service cost centres are adequately handled in a spread sheet environment.
16. It is useful to remember that the use of sophistication in distribution methods does not improve the quality of the costing system. It is the direct capturing of costs to cost centres, the appropriateness of defining the cost centres and the use of proper measures of benefits received that will improve the costing. Ultimately it is the analysis of what triggers the cost that is relevant.
17. Ultimately all overheads must be charged to products of services. Hence the total production overheads of Production Cost Centres are applied to products passing through them using a suitable absorption base. The absorption bases commonly used are listed below (*reproduced from Cost Accounting Standard 3 paragraph 5.6*)

Base of Denominator	Applicability
Unit of Production	When single product is produced or various products are similar in specification
Direct labour cost	When conversion process is labour intensive and wage rates are substantially uniform
Direct labour hour	When conversion process is labour intensive
Machine hour or Vessel Occupancy or Reaction hour or Crushing hour etc	When production mainly depends on performance of the base

18. Before the final step of absorption, production overheads of production cost centres have to be segregated between fixed overheads and variable overheads. The fixed overheads are absorbed by products based on normal capacity or actual capacity utilization whichever is higher. Variable overheads are absorbed by products based on actual capacity utilization. This treatment is in line with Accounting Standard as well.
19. Under absorbed fixed overheads are charged to Costing Profit & Loss Account and shown as an item of Reconciliation with financial accounts.
20. Normal capacity is defined in *Cost Accounting Standard - 2* as the production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance. It is practical capacity minus the loss of productive capacity due to external factors⁶³. In arriving at the practical capacity, the following are factored:
 - holidays
 - number of shifts

⁶³ CAS 2 Paragraph 4.4

- shift duration
 - annual maintenance
 - preventive maintenance if it involves overtime
 - batch change over time
 - lunch break, personnel changeover etc.,
 - production per hour which is in turn based technical specifications, loss in efficiency due to ageing, operational constraints etc.
21. It is usual to employ a predetermined overheads rate throughout the year based on budgeted overheads and budgeted production base and to absorb overheads on the basis of actual production multiplied by the predetermined overhead rate.
 22. The difference between the absorbed overheads and the actual overheads arises due to,
 - variation between the budgeted level of capacity utilization and actual production and
 - variation between budgeted level of overheads and actual overheads.
 23. It is easy to lose perspective on the amount of overhead absorbed by different product in the web of calculations involved in allocation, apportionment and absorption. Operating managers have great difficulty in comprehending the result of a complex allocation, apportionment and absorption algorithm. A simple casual relationship is better understood. It may be preferable to limit complex distribution models if required to major items of overheads and to use simple adhoc methods for the balance overheads.

ADMINISTRATIVE OVERHEADS

1. Administrative overheads must be understood as costs of administrative functions in an entity and not as a collection of elements of costs such as travel, communication, printing and stationery etc.
2. Administrative overheads are of two types:
 - (a) Costs of administrative support functions which support operations such as Purchase, Personnel, Accounts, Factory Administration, Marketing Support etc.,
 - (b) Costs of policy making and strategic management such as Finance, Human Resource Development etc.
3. The functions covered in (a) above are generally attached to a unit like Factory Administration or Marketing administration and are readily identified with production or selling and distribution function.
4. Even when they are located in a Head Office or Corporate Office, it should make little difference, because they cater to the needs of specific functions in the entity. For example, purchase may be located in a central office but they cater to the requirements of specific factories or manufacturing and costs can be assigned to such units.
5. The assignment of such costs to functions and activities benefited by them is feasible subject to limits. The use of activity- based costing can lead to identification of activities within the administrative function and what causes them. Thus the Head office Purchase activity costs can be assigned to user functions based on some measure of activity like no of purchase requisitions.
6. The use of the terms "share of administrative overheads relating to production" and "share of administrative overheads relating to selling" in the erstwhile Companies (Cost Records and Audit) Rules, 2014 has led to arbitrary practices in some entities to assign all administrative overheads on an arbitrary ratio say 60:40 between production and selling. These terms can only refer to administrative costs of functions attached to production or selling. There will be a residuary head of "Administrative Overheads" which cannot be assigned to production or selling functions representing costs of policy making and strategic management and are to be treated as period costs. Also included in this category are expenses such as Directors sitting fees, audit fees, filing fees and other corporate expenses. Paragraph 6.3 in Cost Accounting Standard 3 on overheads should be interpreted in the light of the above discussions.
7. It is significant to note that the reporting format under the new Companies (Cost Records and Audit) Rules, 2014 has a separate line item for Administrative overheads.



8. The assignment of as much of the administrative overheads as possible based on identified cost drivers is recommended. The balance of administrative overheads can only be assigned to cost centres or objects based on capacity or sales value. It is usual in textile industry to charge corporate office cost to mills based on installed spindle capacity.

SELLING AND DISTRIBUTION OVERHEADS

1. The use of the term "Selling and Distribution Overheads" includes items of costs that are not "overheads" but are direct to products such as commission on sales, freight etc. The use of the term "Selling and Distribution Costs" is to be preferred.
2. It is necessary to distinguish "selling" costs from "distribution costs". The latter relate mainly to costs incurred before sales are generated and are therefore indirect to product while distribution costs are more direct to products.
3. It is also usual to speak of "order getting" costs and "order filling" costs to distinguish between the two sets of costs.
4. Selling costs are generally fixed in nature except for commission on sales and the like.

Examples of selling costs are:

- a. Salaries of sales personnel
 - b. Travelling expenses of sales personnel
 - c. Commission to sales agents
 - d. Advertisement costs
 - e. Sales promotion expenses including cost of promotional material such as product brochures, catalogues etc.,
 - f. Collection costs including legal expenses for recovery of dues
 - g. After sales service costs
 - h. Warranty costs etc.,
5. Selling overheads or selling costs are a combination of direct costs relating to selling of products or service and indirect costs of sales management.
 6. Distribution overheads or distribution costs are the costs incurred in handling a product from the time it is ready for dispatch until it reaches the ultimate consumer.
 7. Distribution costs include:
 - a. Secondary packing cost
 - b. Packing repacking / labelling at an intermediate storage location
 - c. Transportation costs
 - d. Cost of warehousing (cover depots, godowns, storage yards, stock yards etc.,)
 8. Transportation costs comprises of the cost of freight, loading and unloading, transit insurance, costs of operating a fleet and other incidental charges whether incurred internally or paid to an outside agency for transportation of goods.
 9. Broadly transportation costs are divided into two categories;
 - a. Cost of operating own fleet
 - b. Cost of hired transport
 10. Costs under either category may include costs;
 - a. Directly allocable to products or
 - b. To be apportioned to products

11. A good costing system should be able to record separately transportation cost from factory to depots and from depot to customers place, wherever practicable and economically feasible.
12. Penalty, detention charges, demurrage charges and other abnormal costs are excluded from transportation cost.

INTEREST AND FINANCE CHARGES

1. This cost head includes the following items of cost:
 - a. Interest on debentures and bonds
 - b. Interest on long term loans
 - c. Interest on working capital finance in the form of cash, credit or overdraft including short term loans
 - d. Interest on overdue payments to suppliers and others
 - e. Discounting charges on bills of exchange
 - f. Bank charges on bills negotiated through Bank for sales or purchases
 - g. Letter of credit charges
 - h. Guarantee commission/ commitment charges
 - i. Cash discount and many more

Interest and Finance charges are accumulated under suitable heads as in (1) above in the financial books before they are taken to cost accounts.

2. For a long time, it was the practice in India to ignore interest as an element of cost following text book discussions on whether interest is a cost.
3. Interest and finance charges are shown separately in point no. 29 of annexure 2 of Part-B of CRA-3 of Companies (Cost Records and Audit) Rules, 2014.
4. Similarly it is usual to develop an average rate of interest paid on various forms of finance for working capital and apply it to working capital investment in product lines or products.
5. Working capital investment by product line is arrived at directly in most cases or apportioned on the following
 - Raw material stocks – Direct or on the basis of raw materials consumed
 - Stores – generally on the basis of stores consumed excluding special high value items which can be identified directly.
 - Work-in-process and finished goods - Direct
 - Book debts – Direct or on the basis of sales (gross)
 - Other current assets – except high value items which can be directly identified with products, on the basis of sales or cost of sales.
6. It is also not unusual to arrive at the working capital investment on the basis of length of the operating cycle in no of days for each product line multiplied by cost of sales or sales.
7. Other finance charges are identified by product lines or products for big items of expenditure or otherwise grouped and charged to product lines or products based on cost of materials consumed, cost of production, and cost of sales or sales.
8. Where the assignment is done initially to product lines as for interest on long term loans, such charges are assigned to individual products on the basis of cost of sales or sales.

10. Applicability of Cost Accounting Practices

1. The above discussions embody the cost accounting practices followed in various industries while applying the cost accounting principles.

However they may vary from practices adopted by specific regulated industries like banks, electricity, fertilisers. In many cases these practice are laid down by the regulator and are followed without fail in the industry. For example, depreciation rates based on life of equipment are prescribed by the regulatory agency in the electricity generation industry and will prevail over the practices mentioned earlier regarding depreciation rates.

Study Note - 5

COST AUDITING STANDARDS



This Study Note includes

5.1 Cost Auditing Standards

5.1 COST AUDITING STANDARDS

Introduction

This Preface to the Standards on Quality Control, Auditing, Assurance, Review, and Related Services rendered by the Cost Accountants (CMAs) has been issued to facilitate understanding of the scope and authority of the pronouncements of the Cost Audit and Assurance Standards Board (CAASB) issued under the authority of the Council of the Institute of Cost Accountants of India.

The Institute of Cost Accountants of India is committed to the goal of developing the cost and management accountancy profession in India. In furtherance of this goal, the Institute develops and promulgates technical standards and other professional literature.

The Institute of Cost Accountants of India is a founder member of the International Federation of Accountants (IFAC). The International Auditing and Assurance Standards Board (IAASB) established by the IFAC has issued series of International Standards on Auditing, which primarily focus on the Financial audit. There are fundamental differences between the scope and methodology of financial and cost audit. Therefore, it will not be appropriate to adopt in full or with modifications the International Standards on Auditing issued by the IAASB. However in formulating the standards, the CAASB will ensure that the framework and other aspects of the International Standards are considered, to the extent relevant and applicable to cost audit.

Government of India, Ministry of Corporate Affairs, vide their letter no. 52/33/CAB/2013 dated 10th September, 2015 has, under section 148(3) of the Companies Act, 2013, granted Central Government's approval to the following Cost Auditing Standards:

1. Cost Auditing Standard-101 on Planning an audit of Cost Statements;
2. Cost Auditing Standard-102 on Cost Audit Documentation;
3. Cost Auditing Standard-103 on Overall objectives of the independent cost auditor; and
4. Cost Auditing Standard-104 on Knowledge of business, its processes and the business

Cost Auditing Standard on Planning an Audit of Cost Statements - 101

The following is the **Cost Auditing Standard (Cost Auditing Standard- 101)** on “**Planning an Audit of Cost Statements**”. In this Standard, the standard portions have been set in **bold italic** type. This Standard should be read in the context of the background material, which has been set in normal type.

1. Introduction

Planning an audit of cost statements, records and other related documents is considered necessary to ensure achievement of audit objectives with available resources and securing coordination with the auditee on audit work.

2. Objective

The objective of this Standard is to guide the members in planning for the audit of cost statements so that it is performed in an efficient and effective manner. Audit planning shall also include establishing the overall audit strategy and audit plan for the conduct of the audit.

3. Scope

This Standard deals with the auditors’ responsibility to plan an audit of cost statements, records and other related documents. The auditor shall prepare and document the overall audit strategy and audit plan.

4. Definitions

The following terms are being used in this standard with the meaning specified.

- 4.1 **Audit:** *Audit is an independent examination of financial, cost and other related information of an entity whether profit oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.*
- 4.2 **Audit Partner:** *Audit partner means the partner in the firm who is a member of the Institute of Cost Accountants of India and is in full time practice and is responsible for the audit and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.*
- 4.3 **Audit Plan:** *A record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks.*
- 4.4 **Audit Risk:** *Audit risk is the risk that the cost auditor expresses an inappropriate audit opinion on the cost statements that are materially misstated. Audit risk is a function of the risk of material misstatement and detection risk.*
- (a) *The risk of material misstatement has two components viz. Inherent Risk and Control risk.*
- (1) *Inherent risk: the susceptibility of an assertion about the measurement, assignment or disclosure of cost to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.*
- (2) *Control risk: the risk that a misstatement that could occur in an assertion about the measurement, assignment or disclosure of cost and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal, operational and management control.*
- (b) *Detection risk: the risk that the procedures followed by the cost auditor to reduce audit risk to an acceptable low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.*
- 4.5 **Audit Team:** *Audit team means all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.*
- 4.6 **Auditee:** *Auditee means a company or any other entity for which cost audit is being carried out.*



- 4.7 **Cost Audit:** *Cost audit is an independent examination of cost statements, cost records and other related information of an entity including a non-profit entity, when such an examination is conducted with a view to expressing an opinion thereon.*
- 4.8 **Cost Auditor:** *“Cost Auditor” means an auditor appointed to conduct an audit of cost records and shall be a cost accountant within the meaning of The Cost and Works Accountants Act 1959. “Cost Accountant” is a cost accountant as defined in clause (b) of sub-section (1) of section 2 of The Cost and Works Accountants Act, 1959 (23 of 1959) and who holds a valid certificate of practice under subsection (1) of section 6 and who is deemed to be in practice under subsection (2) of section 2 of that Act and includes a firm of cost accountants.*
- 4.9 **Firm:** *Firm means a sole practitioner, partnership including LLP (Limited Liability Partnership) or any other entity of professional cost accountants as may be permitted by law and constituted under The Cost and Works Accountants Act & Regulations.*
- 4.10 **Initial Audit:** *Initial audit means an audit where:-*
- (a) *The entity is subject to audit for the first time, as per the applicable laws, or*
 - (b) *The audit of the entity for the prior period was conducted by a different audit firm.*
- 4.11 **Misstatement:** *A difference between the amounts, classification, presentation or disclosure of a reported cost statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable cost reporting framework. Misstatements can arise from error or fraud.*

Where the cost auditor expresses an opinion on whether the cost statements give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the cost auditor’s judgment, are necessary for the cost statements to be presented fairly, in all material respects, or to give a true and fair view.

- 4.12 **Overall Audit Strategy:** *Overall Audit Strategy sets the scope, timing and direction of the audit, and guides the development of the detailed audit plan.*
- 4.13 **Risk Assessment:** *The audit procedures performed to obtain an understanding of the entity and its environment, including the entity’s internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the overall cost statement level and at the assertion level including items of cost, cost heads and disclosure thereof.*

5. Requirements

5.1 Prior to entering the planning phase, the Cost Auditor shall ensure that:

- (a) *the appointment as cost auditor is proper, he has received the letter of appointment and legal formalities regarding his appointment have been complied with;*
- (b) *the ethical requirements as per the regulations continue to be satisfied; (Refer 6.3)*
- (c) *an understanding of the terms of reference including the units to be covered, products/services to be covered, scope of coverage where the regulations leave it to be agreed between the auditor and the auditee.*

5.2 *The audit partner and other key members of an audit team shall be involved in planning the audit, including planning and participating in the discussion among audit team members. (Refer 6.4)*

5.3 *The Cost Auditor shall formulate an Overall audit strategy that sets the scope, timing and direction of the audit.*

The overall audit strategy guides the development of the audit plan.

5.4 *In formulating the Overall audit strategy, the Cost Auditor shall consider all relevant factors. (Refer 6.5)*

These relevant factors include:

- (a) *results of preliminary activities as specified in 5.1 above*
- (b) *knowledge from previous audits and other engagements with the auditee*

- (c) knowledge of business
- (d) nature and scope of the audit
- (e) statutory deadlines and reporting format
- (f) relevant factors determining the direction of the audit efforts
- (g) nature, timing and extent of resources required for the audit.

5.5 The Cost Auditor shall develop an audit plan.

The audit plan will include the nature, extent and timing of risk assessment, audit procedures and other activities (Refer 6.5, 6.6)

5.6 The Cost Auditor shall plan the nature, extent and timing of the direction and supervision of audit team members and the review of their work.(Refer 6.7)

5.7 The Cost Auditor shall update the Overall audit strategy and the audit plan as required during the course of audit. (Refer 6.8)

5.8 The Cost Auditor shall document the overall audit strategy, the audit plan and any significant changes made therein during the audit engagements and the reasons for the changes.

5.9 In the initial audit, the Cost Auditor shall perform procedures regarding the acceptance of the client relationship and the specific audit.

In case where the audit of the entity for the prior period was conducted by a different audit firm, the auditor shall communicate with the previous auditor. (Refer 6.9)

6. Application Guidance

6.1 The nature and extent of planning activities will vary according to the:

- (a) size and complexity of the entity's activities, the number of products to be covered, the processes and operations involved.
- (a) the audit team members' previous experience with the entity and the industry.
- (b) changes in circumstances that occur during the audit.

6.2 Planning is not a discrete phase of an audit, but rather a continuous and iterative process. Planning includes scheduling which involves determining the priority of audit procedures and their inter dependence. For example, the risk assessment procedures are planned early in the audit process.

6.3 Prior to the performance of other significant activities for the current year's audit, the auditor shall ensure that {Refer 5.1 (b)} :

- (a) After the Cost Auditor has accepted the appointment for an entity, there are no changes in his position in relation to the entity that impede his arm's length relationship with the entity. Such as, acceptance of an assignment relating to designing and implementation of cost accounting system for the entity.
- (b) Subsequent to his acceptance of the assignment, no issues about management integrity has cropped up that may affect the auditor's willingness to continue the engagement.

6.4 The involvement of the audit partner and other key members of the audit team in planning the audit draws on their experience and insights, thereby enhancing the effectiveness and efficiency of the planning process. (Refer 5.2)

6.5 Matters that are relevant in formulating the overall audit strategy and drawing up the audit plan include, in addition to those mentioned earlier, the following (Refer 5.4, 5.5):

- (a) The cost reporting framework generally prescribed, under the Companies Act and Rules prescribed thereunder, as well as under any other law as applicable, on the basis of which the cost information to be audited has been prepared, including need for reconciliation with financial reporting framework.
- (b) Industry regulators' requirement as to how costs will be handled.



- (c) Unique features of an industry that influence audit requirements such as definition of product in the newspaper industry.
 - (d) Reliance that can be placed on the work of financial auditors, other cost auditors appointed by the entity and internal auditors. such as their attendance in annual stocktaking
 - (e) State of IT (Information Technology) implementation, whether the entity is using an ERP (Enterprise Resource Planning) system or internally developed systems and the reliance that can be placed on them.
 - (f) Statutory timelines for cost reporting, which can be modified by the management for early completion.
 - (g) Timelines for Board/ audit committee meetings, which can set the time limits for completion of audit work.
 - (h) Resources required and available in terms of manpower, equipment and others and the assignment of these to specific parts of the work.
- 6.6 The audit plan is more detailed than the overall audit strategy as it includes the nature, timing and extent of audit procedures to be performed by audit team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. (Refer 5.5)
- 6.7 The nature, extent and timing of the direction and supervision of audit team members and review of their work vary depending on, among others, the size and complexity of the entities activities, risk assessment results and the capabilities and competence of the individual team members performing the audit work. (Refer 5.6)
- 6.8 As a result of unexpected events, changes in conditions or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan. (Refer 5.7)
- 6.9 Additional Consideration in Initial Audit Engagements (Refer 5.9): The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For the initial audit, additional matters the auditor may consider in formulating the overall audit strategy and audit plan include the following.
- (a) The planning activities may expand to cover consultations with the previous auditor, review of previous year's audit working papers, if not prohibited by other Law or regulation, and previous year's transactions having an impact on current year's cost.
 - (b) Any major issues (including the application of cost accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as cost auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.
 - (c) The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (such as Inventory).
 - (d) Other procedures required by the firm's system of quality control for initial cost audit engagements (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).
- 6.10 In audits of small entities where the entire audit may be conducted by a small audit team comprising the audit partner working with say one team member, formulating the audit strategy and drawing up the audit plan need not be elaborate. Nonetheless it is necessary to have regard to the matters mentioned under Requirements.

7. Effective Date

This Standard is effective for audits on or after September 11, 2015.

Cost Auditing Standard on Cost Audit Documentation – 102

The following is the **Cost Auditing Standard (Cost Auditing Standard- 102)** on “**Cost Audit Documentation**”. In this Standard, the standard portions have been set in ***bold italic*** type. This Standard should be read in the context of the background material, which has been set in normal type.

1. Introduction

The purpose of this Standard is to provide guidance to the members in preparation of Audit Documentation in the context of the audit of cost statements, records and other related documents.

Nature and Purpose of Cost Audit Documentation

Cost Audit documentation that meets the requirement of this Cost Auditing Standard and the specific documentation requirements of other relevant Cost Auditing Standards provides:

- (a) Evidence of the cost auditor’s basis for a conclusion about the achievement of the overall objectives of the cost auditor; and
- (b) Evidence that the cost audit was planned and performed in accordance with Cost Auditing Standards and applicable legal and regulatory requirements.

Cost Audit documentation serves a number of additional purposes, including the following:

- (a) Assisting the audit team to plan and perform the cost audit.
- (b) Assisting members of the audit team responsible for supervision to direct and supervise the cost audit work, and to discharge their review responsibilities.
- (c) Enabling the audit team to be accountable for its work.
- (d) Retaining a record of matters of continuing significance to future cost audits.
- (e) Enabling the conduct of quality control reviews in accordance with the Guidance Manual for Audit Quality issued by Quality Review Board (QRB).
- (f) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

2. Objective

The objective of this Standard is to guide the members to prepare documentation that provides:

- (a) A sufficient and appropriate record of the basis for the Cost Auditor’s Report; and***
- (b) Evidence that the audit was planned and performed in accordance with Cost Auditing Standards and applicable legal & regulatory requirements.***

3. Scope

This Standard deals with the cost auditor’s responsibility to prepare audit documentation for the audit of cost statements, records and other related documents. The specific documentation requirements of other Cost Auditing Standard’s do not limit the application of this Cost Auditing Standard. Laws or regulations may establish additional documentation requirements.

4. Definitions

The following terms are being used in this Standard with the meaning specified.

- 4.1 Audit: Audit is an independent examination of financial, cost and other related information of an entity whether profit oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.***
- 4.2 Audit documentation: Audit Documentation means the records, in physical or electronic form, including working papers prepared by and for, or obtained and retained by the Cost auditor, in connection with the performance of the audit.***



- 4.3 Audit file:** *Audit file means one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific Assignment or audit.*
- 4.4 Audit Partner:** *Audit partner means the partner in the firm who is a member of the Institute of Cost Accountants of India and is in full time practice and is responsible for the audit and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.*
- 4.5 Audit Team:** *Audit team means all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.*
- 4.6 Audit working papers:** *Audit working papers are the documents which record all audit evidence obtained during audit. Such documents are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the relevant Cost Auditing Standards.*
- 4.7 Cost Auditor:** *“Cost Auditor” means an auditor appointed to conduct an audit of cost records and shall be a cost accountant within the meaning of The Cost and Works Accountants Act 1959. “Cost Accountant” is a cost accountant as defined in clause (b) of sub-section (1) of section 2 of The Cost and Works Accountants Act, 1959 (23 of 1959) and who holds a valid certificate of practice under subsection (1) of section 6 and who is deemed to be in practice under subsection (2) of section 2 of that Act and includes a firm of cost accountants.*
- 4.8 Firm:** *Firm means a sole practitioner, partnership including LLP (Limited Liability Partnership or any other entity of professional cost accountants as may be permitted by law and constituted under The Cost and Works Accountants Act & Regulations.*

5. Requirements

- 5.1** *The cost auditor as part of the audit documentation shall record audit procedures performed, relevant audit evidence obtained, and conclusions reached. (Refer 6.1)*
- 5.2** *The Cost Auditor shall prepare audit documentation that is sufficient to enable another competent person, having no previous connection with the said audit, including person undertaking peer review to understand:*
- (a) Conformance of audit procedures performed with legal and regulatory requirements;*
 - (b) Conformance to Cost Auditing Standards. (Refer 6.6)*
 - (c) The results of audit procedures performed*
 - (d) The audit evidence obtained*
 - (e) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Refer 6.7 & 6.8)*
- 5.3** *The Cost Auditor shall record the discussions of significant matters with client personnel and outsiders. (Refer 6.9).*
- 5.4** *The Cost Auditor shall record any departure from the standard requirement in a Cost Auditing Standard. (Refer 6.11)*
- 5.5** *In documenting the nature, timing and extent of audit procedures performed, the Cost Auditor shall record the characteristics of the specific items or matters tested, the persons responsible for performing and reviewing such procedures with relevant dates and extent of review. (Refer 6.12)*
- 5.6** *The Cost Auditor shall prepare audit documentation on a timely basis. (Refer 6.14)*
- 5.7** *If, in exceptional circumstances, Cost Auditor performs any new or additional audit procedures or draws new conclusions, after the date of Cost Audit Report, then he shall document such circumstances and details of such procedures performed. (Refer 6.15)*
- 5.8** *The cost auditor shall assemble the audit documentation in an audit file. (Refer 6.16)*

6. Application Guidance

6.1. The Cost Audit documentation will usually contain:

(a) *Checklists*

Example: Checklist of compliance with:-(1) The Rules, regarding maintenance of Cost Records, as prescribed under the Companies Act,

(2) The Cost Accounting Standards (CAS) as prescribed by the Institute

(3) The Generally Accepted Cost Accounting Principles (GACAP) as prescribed by the Institute

(b) *Audit programs*

Example: Audit Program for Material Cost, Employee Cost and others

(c) *Analysis*

Cost Audit relies more on analytical review than on substantive testing to establish true and fair view.

Example: Calorific value of different fuels used and average Cost per unit of calorific value and Specific Heat Consumption.

(d) *Audit Query List*

Contains a log of audit queries raised and their resolution

(e) *Abstracts of significant contracts relating to costs and revenues*

Example: Supply of materials indicating price, quality terms, O & M contracts, Terms of supply of contract labour and others

(f) *Letters of confirmation*

Example: Stock of materials with subcontractors.

(g) *Letter of Representation from Management Correspondence (including e-mail) concerning significant matters.*

Example: Correspondence regarding terms of supply of goods and services.

(h) *Abstract or copies of the entity's records*

6.2. Audit documentation may be in paper form or electronic form. Where it is in electronic form, special care may be required to protect against accidental deletion, or tampering.

6.3. The content and form of audit documentation will depend on a number of factors such as:

(a) the size and complexity of the operations of the auditee,

(b) the extent of computerization of cost records,

(c) the assessed risks of material misstatement of cost,

(d) the cost audit methodology and tools used. For example whether automated queries were used to get audit evidence from cost records.

(e) the nature of the audit procedure to be performed.

6.4. In particular, it is necessary to document the basis for a conclusion, not readily determinable from other documentation. For example: consumption of materials by a product from technical norms, normal price for a related party contract from Cost Auditor's own sources of data of the industry.



- 6.5. Audit documentation must be sufficient and appropriate, and oral explanations by the Cost Auditor cannot substitute for such documentation.
- 6.6. Audit documentation must contain evidence of conformance to requirements of Cost Auditing Standards in respect of this Standard and other standards {Refer 5.2(b)}:
- Typical of such evidence are:
- (a) an adequately documented audit plan
 - (b) the signed appointment letter from the auditee
 - (c) Minutes of discussion with client personnel, with names of members of audit team present, particularly of the audit partner when he is present
 - (d) Minutes of audit team discussions, with names of members of audit team present, particularly of the audit partner when he is present.
- 6.7. Matters that give rise to significant risks of a material misstatement are significant matters. Those that causes a revision of the Cost Auditor's previous assessment of the risks of material misstatement is also a significant matter. The Cost Auditor may have reached a certain conclusion regarding the misstatement of the Material Cost in a Cost statement based on the availability of a well documented Bill of Materials but his assessment of risk may undergo a change if he finds that there is considerable use of substitute and alternate materials in the actual production process. Matters that cause the Cost Auditor significant difficulty in applying necessary audit procedures are also significant, as for example heaps of bulk material in irregular shapes which make volumetric measurement of stock in a physical stock taking unreliable. {Refer 5.2(e)}
- 6.8. Determining what are significant matters in an audit to warrant their inclusion in the documentation must be objectively done. The conclusions reached and the application of professional judgment in respect of these also needs to be documented. For example the determination of the normal capacity for applying overheads is a significant matter in Cost Audit and requires not mere calculations but considerable judgment. These should be adequately documented. {Refer 5.2(e)}
- 6.9. Records of discussions include Minutes of discussion of significant matters with management, those charged with governance and others. It also includes Discussion with third parties seeking information or confirmation. (Refer 5.3)
- 6.10. The Cost Audit Documentation in respect of smaller entities may be less detailed than what is indicated but must include at the minimum the following:
- (a) A description of the entity, the products produced, services provided and other activities
 - (b) An organization Chart showing the responsibility centres and the person responsible
 - (c) A description, preferably a flow chart of the manufacturing process
 - (d) Internal controls over material cost, labour cost and expenses
 - (e) The risks of material misstatement assessed, for example, in respect of scrap recovery and disposal
 - (f) Tests of materiality used
 - (g) The overall audit strategy and audit plan
 - (h) Significant matters noted during the audit, and conclusions reached
- 6.11. If, in exceptional circumstances, the Cost Auditor finds it necessary to perform alternative audit procedures different from a corresponding requirement in a Cost Auditing Standards, the Cost Auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure. (Refer 5.4)

- 6.12. It is necessary in a Cost Audit to identify the specific matters or items tested. In connection with a Cost Audit these may include Purchase Orders for supply of key raw materials, Goods Receipt Notes for materials, Issue notes for materials, bills of contractors for supply of contract labour among others. Where the Cost Auditor resorts to test checking, the basis used for selection, for example issues of spares above a certain value, and the documents selected. (Refer 5.5)
- 6.13. Names of the team member preparing specific audit documents and details of their review by the Cost Auditor are a necessary part of the Audit Documentation.
- 6.14. Preparing the audit Documentation on timely basis helps to enhance the quality of audit. Documentation prepared after the audit work has been performed is likely to be less accurate than the documentation prepared during execution. (Refer 5.6)
- 6.15. Facts which become known to the Cost Auditor after the date of the audit report but which if known earlier would have caused the cost statements to be changed or the Cost Audit Report to be modified should be added to the Cost Audit Documentation. The resulting changes to the audit documentation must also be reviewed as the original documentation. (Refer 5.8)
- 6.16. The Cost Audit Documentation must be assembled as the audit goes on and the final assembly required of audited documentation must be limited. Assembly the final audit file should be completed within a reasonable time after the completion of the audit. After the assembly of the final audit file has completed, the auditor should not delete or discard audit documentation of any nature before the end of its retention period. (Refer 5.9)
- 6.17. The audit documentation is the property of the Cost Auditor. Unless otherwise specified by law or regulation, he may at his discretion, make portions of, or extracts from audit documentation available to clients
- 6.18. The Cost Audit Documentation should be retained for at least ten years from the date of the Cost Audit Report.

7. Effective Date

This Standard is effective for audits on or after September 11, 2015.



Cost Auditing Standard Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards - 103

The following is the **Cost Auditing Standard** (Cost Auditing Standard - 103) on "**Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards**". In this Standard, the standard portions have been set in **bold italic** type. This Standard should be read in the context of the background material, which has been set in normal type.

1. Introduction

This Standard on Auditing deals with the overall objectives of the independent cost auditor, the nature and scope of a Cost audit the independent auditor's overall responsibilities when conducting an audit of cost statements in accordance with Cost Auditing Standards. It also explains the requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the Cost Auditing Standards.

The independent Cost Auditor is referred to as "Cost auditor" hereafter.

2. Objectives

The objective of this Standard is to lay down the overall objectives of the Cost Auditor and ensuring the Conduct of the Audit of Cost Statements in accordance with the Cost Auditing Standards.

The Cost auditor's overall objectives are:

- 2.1. **to obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud or error, and to enable the auditor to express an opinion whether the Cost Statements are prepared, in all material respects, in accordance with the applicable Cost reporting framework, Cost Accounting Standards(CAS) and Generally Accepted Cost Accounting Principles (GACAP) as issued by the Institute, and give a true and fair view of the Cost of a product, activity or service. In the case of a Cost Audit under the Companies Act and Rules prescribed thereunder, the objective is to express an opinion on whether the Cost Statements subject to audit represent a true and fair view of the cost of production, cost of sales and margin of products covered by the Cost Audit.**
- 2.2. **to report on the cost statements in the form required by law or by the Cost Auditing Standards in accordance with the auditor's findings.**

Where reasonable assurance cannot be obtained, the cost auditor should qualify the opinion and in extreme cases disclaim an opinion.

The Cost Auditors objective may extend to making observations and suggestions where required by applicable regulations.

3. Scope

The scope of this standard is to establish overall objectives of the cost auditor while conducting an audit of cost statements, in accordance with the cost auditing standards.

It also describes management responsibility for the preparation and presentation of the Cost Statement, to identify the Cost Reporting framework and to lay down Cost Accounting policies.

4. Definitions

The following terms are being used in this standard with the meaning specified.

- 4.1. **Audit: Audit is an independent examination of financial, cost and other related information of an entity whether profit oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.**

- 4.2. Audit Partner:** *Audit partner means the partner in the firm who is a member of the Institute of Cost Accountants of India and is in full time practice and is responsible for the audit and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.*
- 4.3. Audit Risk:** *Audit risk is the risk that the cost auditor expresses an inappropriate audit opinion on the cost statements that are materially misstated. Audit risk is a function of the risk of material misstatement and detection risk.*
- (a) The risk of material misstatement has two components viz. Inherent Risk and Control risk.**
- (1) Inherent risk:** *the susceptibility of an assertion about the measurement, assignment or disclosure of cost to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.*
- (2) Control risk:** *the risk that a misstatement that could occur in an assertion about the measurement, assignment or disclosure of cost and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal, operational and management control.*
- (b) Detection risk:** *the risk that the procedures followed by the cost auditor to reduce audit risk to an acceptable low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.*
- 4.4. Audit Team:** *Audit team means all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.*
- 4.5. Auditee:** *Auditee means a company or any other entity for which cost audit is being carried out.*
- 4.6. Auditor:** *Auditor is used to refer to the person or persons conducting the audit, usually the audit partner or other members of the audit team, or, as applicable the firm. Auditor includes Cost Auditor*
- 4.7. Cost Audit:** *Cost audit is an independent examination of cost statements, cost records and other related information of an entity including a non-profit entity, when such an examination is conducted with a view to expressing an opinion thereon.*
- 4.8. Cost Auditor:** *"Cost Auditor" means an auditor appointed to conduct an audit of cost records and shall be a cost accountant within the meaning of The Cost and Works Accountants Act 1959. "Cost Accountant" is a cost accountant as defined in clause (b) of sub-section (1) of section 2 of The Cost and Works Accountants Act, 1959 (23 of 1959) and who holds a valid certificate of practice under subsection (1) of section 6 and who is deemed to be in practice under subsection (2) of section 2 of that Act and includes a firm of cost accountants.*
- 4.9. Firm:** *Firm means a sole practitioner, partnership including LLP (Limited Liability Partnership) or any other entity of professional cost accountants as may be permitted by law and constituted under The Cost and Works Accountants Act & Regulations.*
- 4.10. Management:** *The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance.*
- 4.11. Misstatement:** *A difference between the amounts, classification, presentation or disclosure of a reported cost statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable cost reporting framework. Misstatements can arise from error or fraud.*

Where the cost auditor expresses an opinion on whether the cost statements give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the cost auditor's judgment, are necessary for the cost statements to be presented fairly, in all material respects, or to give a true and fair view.



- 4.12. **Non-compliance:** Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations governing Cost Accounting, Cost Records and Cost Audit. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.
- 4.13. **Overall Audit Strategy:** *Overall Audit Strategy sets the scope, timing and direction of the audit, and guides the development of the detailed audit plan.*
- 4.14. **Professional Judgment:** The application of relevant training, knowledge and experience, within the context provided by cost auditing standards, cost accounting standards and ethical requirements, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.
- 4.15. **Professional Skepticism:** An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatements due to error or fraud, and a critical assessment of audit evidence.
- 4.16. **Risk Assessment:** *The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the overall cost statement level and at the assertion level including items of cost, cost heads and disclosure thereof.*
- 4.17. **Those charged with governance:** The person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. **This includes overseeing the financial reporting process.** For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

5. Requirements

- 5.1. **The cost auditor shall comply with the relevant ethical requirements including those pertaining to independence in respect of cost audit engagements. (refer 6.1)**
- 5.2. **While conducting an audit, the cost auditor shall comply with each of the Cost Auditing Standards relevant to the audit. A Cost Auditing Standard is relevant to the audit when the Cost Auditing Standard is in effect and the circumstances addressed by the Cost Auditing Standard exist. (refer 6.2)**
- 5.3. **The cost auditor shall have an understanding of the entire text of the Cost Auditing Standard, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.**
- 5.4. **The cost auditor shall not represent compliance with the cost auditing standards in the cost auditor's report unless the auditor has complied fully with all of the Cost Auditing Standards relevant to the audit.**
- 5.5. **In exceptional circumstances, the cost auditor may judge it necessary to depart from a relevant requirement in a Cost Auditing Standard. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. {Refer 6.2(c)}**
- 5.6. **The cost auditor shall plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the Cost Statements to be materially misstated. (refer 6.3)**
- 5.7. **The auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (refer 6.4)**
- 5.8. **The cost auditor shall exercise professional judgment in planning and performing the audit.**
- 5.9. **The cost auditor shall determine whether the Cost Reporting Framework followed by management in preparing cost statements is in line with the Companies Act and the Rules prescribed thereunder. (refer 6.5)**

5.10. The cost auditor shall not be required to perform audit procedures regarding the entity's compliance with laws and regulations governing cost audit in the absence of identified or suspected non-compliance. (refer 6.6)

5.11. If an objective in a relevant Cost Auditing Standard cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the Cost Auditing Standards, to modify the auditor's opinion.

6. Application Guidance:

6.1 Audit and Ethics: The cost auditor should comply with relevant ethical requirements as per Code of Ethics issued by the Institute of Cost Accountants of India. This code establishes fundamental principles of professional ethics relevant to the auditor while conducting an audit and provides a conceptual framework for applying these principles. The fundamental principles with which the auditor is required to comply are Independence, Integrity, Objectivity, Professional competence and due care, Confidentiality and Professional conduct. In case of an audit engagement, it is in the public interest that the auditor should be independent of the entity subject to the audit. The cost auditor's independence from the entity safeguards the cost auditor's ability to form an opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity to be objective and to maintain an attitude of professional skepticism. (Refer 5.1)

For Example: The provision of services for maintenance of cost records, design and implementation of Cost Systems and internal audit are considered to erode the independence.

6.2 Conduct of audit: (Refer 5.2)

(a) The Cost Auditing Standards provide the standards for the cost auditor's work in fulfilling the overall objectives of the cost auditor. The Cost Auditing Standards deal with general responsibilities of the cost auditor, as well as cost auditor's further considerations relevant to the application of those responsibilities to specific topics.

(b) In performing an audit, the cost auditor may be required to comply with legal or regulatory requirements in addition to Cost Auditing Standards. In such cases in addition to complying with each of the Cost Auditing Standard relevant to the cost audit, it may be necessary for the cost auditor to perform additional audit procedures in order to comply with the legislative and regulatory requirements. The Cost Auditing Standards do not override law or regulations that govern audit process.

The form of the cost auditor's opinion will depend upon the applicable cost reporting framework and any applicable laws or regulations such as Companies Act and Rules prescribed thereunder.

(c) The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement. (Refer 5.5)

6.3 Professional skepticism: An attitude of professional skepticism means the cost auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and be alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. An attitude of professional skepticism is necessary throughout the cost audit process for the auditor to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions from cost audit observations, and of using faulty assumptions in determining the nature, timing and extent of the cost audit procedures and evaluating the results thereof. When making inquiries and performing other cost audit procedures, the cost auditor should not be satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the cost auditor's opinion. (Refer 5.6)

(a) A cost auditor conducting an audit in accordance with Cost Auditing Standards obtains reasonable assurance that the Cost Statements taken as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the Cost Statements taken as a whole. Reasonable assurance relates to the whole audit process.



A cost auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the cost auditor's ability to detect material misstatements. These limitations result from factors such as the following:

- (1) The use of sample testing.
- (2) The inherent limitations of internal control (for example, the possibility of management override or collusion).
- (3) The fact that most audit evidence is persuasive rather than conclusive.

Also, the work undertaken by the cost auditor to form an audit opinion is permeated by judgment, in particular regarding:

- (1) The gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and
 - (2) The drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management in preparing the Cost Statements.
- (b) Further, other limitations may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions. (For example, transactions between related parties). In these cases certain Cost Auditing Standard identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:
- (1) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or
 - (2) Any indication that a material misstatement has occurred.

Accordingly, because of the factors described above, an audit is not a guarantee that the Cost Statements are free from material misstatement, because absolute assurance is not attainable. Further, an audit opinion does not assure the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

6.4 Audit Risk and Materiality: Entities pursue strategies to achieve their objectives, and depending on the nature of their operations and industry, the regulatory environment in which they operate, and their size and complexity, they face a variety of business risks. Management is responsible for identifying such risks and responding to them. However, not all risks relate to the preparation of the Cost Statements. The auditor is ultimately concerned only with risks that may affect the cost statements. (Refer 5.7)

- (a) The cost auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the Cost Statements give a true and fair view or in accordance with the applicable cost reporting framework. The concept of reasonable assurance acknowledges that there is a risk the audit opinion is inappropriate. The risk that the cost auditor expresses an inappropriate audit opinion when the Cost Statements are materially misstated is known as "audit risk." The cost auditor reduces audit risk by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level.
- (b) Audit risk is a function of the risk of material misstatement in the cost statements (or simply, the "risk of material misstatement") (i.e., the risk that the Cost Statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement ("detection risk"). The cost auditor performs audit procedures to assess the risk of material misstatement and seeks to limit detection risk by performing further audit procedures based on that assessment. The audit process involves the exercise of professional judgment in designing the audit approach, through focusing on what can go wrong (i.e., what are the potential misstatements that may arise) at the assertion level and performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence.
- (c) The cost auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the Cost Statements taken as a whole. The cost auditor considers whether the effect of identified uncorrected misstatements, both individually and in the aggregate, is material to the Cost Statements taken as a whole. Materiality and audit risk are related. In order to design audit procedures to determine whether there are misstatements that are material to the cost statements taken as a whole, the cost auditor considers the risk of material misstatement at two levels:

- (1) the overall cost statement level and
 - (2) In relation to cost heads, items of cost and disclosures and the related assertions.
- (d) The cost auditor considers the risk of material misstatement at the overall cost statement level, which refers to risks of material misstatement that relate pervasively to the Cost Statements as a whole and potentially affect many assertions. Risks of this nature often relate to the entity's control environment (although these risks may also relate to other factors, such as declining economic conditions), and are not necessarily risks identifiable with specific assertions at the cost heads, items of cost or disclosure level. Rather, this overall risk represents circumstances that increase the risk that there could be material misstatements in any number of different assertions, for example, through management override of internal control. Such risks may be especially relevant to the cost auditor's consideration of the risk of material misstatement arising from fraud. The auditor's response to the assessed risk of material misstatement at the overall cost statement level includes consideration of the knowledge, skill, and ability of personnel assigned significant engagement responsibilities, including whether to involve experts; the appropriate levels of supervision;
- (e) The cost auditor also considers the risk of material misstatement at the cost heads, items of cost and disclosure level because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level. The cost auditor seeks to obtain sufficient appropriate audit evidence at the cost heads, items of cost, and disclosure level in such a way that enables the auditor, at the completion of the audit, to express opinion on the Cost Statements taken as a whole at an acceptably low level of cost audit risk. Auditors use various approaches to accomplish that objective. The discussion in the following paragraphs provides an explanation of the components of audit risk.
- (f) The risk of material misstatement at the assertion level consists of two components as follows:
- (1) "Inherent risk" is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls. The risk of such misstatement is greater for some assertions and related cost heads, items of cost and disclosure than for others. For example, complex calculations are more likely to be misstated than simple calculations. Cost heads consisting of amounts derived from cost estimates that are subject to significant measurement uncertainty pose greater risks than do cost heads consisting of relatively routine, factual data.

External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a cause changes to a manufacturing process rendering the existing classification of variable and fixed costs inappropriate and cause product contribution to be misstated. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that relate to several or all of the classes of cost heads, items of cost, or disclosures may influence the inherent risk related to a specific assertion. These latter factors include, for example, external market constraints may cause normal capacity as an unreliable basis for determining unit costs.
 - (2) "Control risk" is the risk that a misstatement that could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control. That risk is a function of the effectiveness of the design and operation of internal control in achieving the entity's objectives relevant to preparation of the entity's Cost Statements. Some control risk will always exist because of the inherent limitations of internal control.
- Inherent risk and control risk are the entity's risks; they exist independently of the audit of the Cost Statements. The auditor is required to assess the risk of material misstatement at the assertion level as a basis for further audit procedures, though that assessment is a judgment, rather than a precise measurement of risk. When the auditor's assessment of the risk of material misstatement includes an expectation of the operating effectiveness of controls, the auditor performs tests of controls to support the risk assessment. The Cost Auditing Standard do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risk of material misstatement." Although the Cost Auditing Standard ordinarily describe a combined assessment of the risk of material misstatement, the auditor may make separate or



combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risk of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

- (g) "Detection risk" is the risk that the cost auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other misstatements. Detection risk is a function of the effectiveness of an audit procedure and of its application by the auditor. Detection risk cannot be reduced to zero because the auditor usually does not examine all of cost heads, items of cost, or disclosure and because of other factors. Such other factors include the possibility that a cost auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through adequate planning, proper assignment of personnel to the audit team, the application of professional skepticism, and supervision and review of the audit work performed.

Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level.

For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risk of material misstatement at the assertion level. The greater the risk of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risk of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.

6.5 Responsibility for the Cost Statements: The cost auditor is responsible for forming and expressing an opinion on the Cost Statements. (Refer 5.9)

The term "Cost Statements" refers to a structured representation of the cost information, which ordinarily includes accompanying notes, derived from cost accounting records and intended to communicate an entity's use of economic resources and the output obtained in accordance with a Cost reporting framework. The term can refer to for example, a cost statement, reconciliation with financial accounts and related explanatory notes.

- (a) The requirements of the Cost reporting framework determine the form and content of the Cost Statements and what constitutes a complete set of Cost Statements. For certain Cost reporting frameworks, a single cost statement as such and the related explanatory notes constitute a complete set of Cost Statements. For example: a Cost Statement under Cost Accounting Standard 4.
- (b) The Cost auditor is not responsible for preparing and presenting the cost statements in accordance with the applicable Cost reporting framework including inter-alia:
- (1) Designing, implementing and maintaining internal control relevant to the preparation and presentation of Cost Statements that are free from material misstatement, whether due to fraud or error;
 - (2) Selecting and applying appropriate Cost accounting policies; and
 - (3) Making cost estimates that are reasonable in the circumstances.

6.6 Non-compliance: The cost auditor shall request management to provide written representation that all known instances of non-compliance or suspected non-compliance with laws and regulations governing Cost Accounting, Cost Records and Cost Audit have been disclosed to the cost auditor. The representations provide necessary audit evidence about management knowledge of identified or suspected non-compliance with laws and regulations whose effects may have a material effect on the cost statement however, written representation do not provide sufficient audit evidence on their own, and accordingly do not affect the nature and extent of other audit evidence that is to be obtained by the cost auditor. (Refer 5.10)

7. Effective Date

This Standard is effective for audits on or after September 11, 2015.

Cost Auditing Standard on Knowledge of Business, its Processes and the Business Environment - 104

The following is the **Cost Auditing Standard (Cost Auditing Standard - 104)** on “**Knowledge of Business, its Processes and the Business Environment**”. In this Standard, the standard portions have been set in **bold italic** type. This standard should be read in the context of the background material, which has been set in normal type.

1. Introduction

In performing an audit of cost statement, records and other related documents, the cost auditor should have the knowledge of the client’s business to enable him to understand the processes and express his opinion on the cost statements.

The cost auditor’s level of knowledge for a cost audit engagement should include a general knowledge of the economy and the industry within which the entity operates, and a more particular knowledge of how the entity operates.

2. Objective

The objective of this standard is to enable the cost auditor to have knowledge of the client’s business which is sufficient to identify and understand the events, transactions and practices that, in the cost auditor’s judgment may have a significant effect on the examination of cost statements or on the preparation of the cost audit report.

3. Scope

This standard deals with obtaining the knowledge of the client’s business, its processes and business environment as it is important for the cost auditor and members of the audit team working on an audit engagement.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 *Audit: Audit is an independent examination of financial, cost and other related information of an entity whether profit oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.*

4.2 *Audit Plan: A record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risk.*

4.3 *Audit Risk: Audit risk is the risk that the cost auditor expresses an inappropriate audit opinion on the cost statements that are materially misstated. Audit risk is a function of the risk of material misstatement and detection risk.*

(a) *The risk of material misstatement has two components viz. Inherent Risk and Control risk.*

(1) *Inherent risk: the susceptibility of an assertion about the measurement, assignment or disclosure of cost to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.*

(2) *Control risk: the risk that a misstatement that could occur in an assertion about the measurement, assignment or disclosure of cost and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal, operational and management control.*

(b) *Detection risk: the risk that the procedures followed by the cost auditor to reduce audit risk to an acceptable low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.*

4.4 *Auditee: Auditee means a company or any other entity for which cost audit is being carried out.*



- 4.5 Cost Auditor:** “Cost Auditor” means an auditor appointed to conduct an audit of cost records and shall be a cost accountant within the meaning of The Cost and Works Accountants Act 1959. “Cost Accountant” is a cost accountant as defined in clause (b) of sub-section (1) of section 2 of The Cost and Works Accountants Act, 1959 (23 of 1959) and who holds a valid certificate of practice under subsection (1) of section 6 and who is deemed to be in practice under subsection (2) of section 2 of that Act and includes a firm of cost accountants.
- 4.6 Overall Audit Strategy:** Overall Audit Strategy sets the scope, timing and direction of the audit, and guides the development of the detailed audit plan.
- 4.7 Risk Assessment:** The audit procedures performed to obtain an understanding of the entity and its environment, including the entity’s internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the overall cost statement level and at the assertion level including items of cost, cost heads and disclosure thereof.

5. Requirements

- 5.1 The Cost Auditor shall have adequate level of understanding of the knowledge of Business, its Processes and the Business Environment to develop a reasonable assurance in order to express an opinion on the cost statements on which he is expressing an opinion.(refer 6.1)**
- 5.2 The Entity and Its Environment:** The cost auditor should obtain an understanding of the following:
- (a) The nature of the entity, (including its operations covering Business processes, major inputs, Joint & By-Products and Wastages and major outputs etc) and the entity’s ownership and governance structure.
 - (b) Relevant industry, regulatory, and other external factors including the applicable cost and financial reporting framework.(refer 6.2)
 - (c) The entity’s selection and application of cost accounting policies.(refer 6.3)
 - (d) The measurement and review of the entity’s performance. (refer 6.4)
- 5.3 The Entity’s Internal Control:** The cost auditor shall obtain an understanding of internal controls relevant to the audit. (refer 6.5)
- (a) **Control Environment:** The cost auditor shall evaluate whether management has created and maintained a culture of honesty and ethical behaviour.
 - (b) **The entity’s risk assessment process:** The cost auditor shall obtain an understanding of whether the entity has a process for: (refer 6.6, 6.7, 6.8)
 - (1) Identifying business risks relevant to cost reporting objectives;
 - (2) Assessing the likelihood of their occurrence;
 - (3) Estimating the significance of the risks; and
 - (4) Deciding about actions to address those risks.
 - (c) **Cost Information System/ Management Information System:** The cost auditor shall obtain an understanding of the Information System including Management Information System, relevant to cost reporting, including the following areas: (refer 6.9)
 - (1) The classes of transactions and their analysis, that are significant to the cost statements;
 - (2) The procedures, by which those transactions and their analysis are initiated, recorded, processed, and reported in the management information systems and cost statements;
 - (3) The related cost accounting records, supporting information that are used to initiate, record, process and report transactions; and

(4) The reporting process used to prepare the entity's cost statements, including significant estimates and disclosures.

(d) Control Activities: The auditor shall obtain an understanding of the control activities, relevant to the audit.(refer 6.10)

(e) Monitoring of controls:

(1) The auditor shall obtain an understanding of the major activities, that the entity uses to monitor internal control over reporting.(refer 6.11)

(2) The cost auditor shall evaluate the adequacy of the internal audit function in relation to cost records. (refer 6.12)

5.4 IT (Information Technology) Environment and Control: The cost auditor shall evaluate and assess: (refer 6.13)

(1) IT Architecture, Systems and programmes in use in the entity;

(2) Controls on access to data;

(3) Controls on changes to data in master files, systems or programmes; an

(4) Integrity of information and security of the data

5.5 Identifying and Assessing the Risks of Material Misstatement: The cost auditor shall identify and assess the risks of material misstatement at the cost statement level; and at the assertion level including items of cost, cost heads and disclosures thereof.

For this purpose, the cost auditor shall: (refer 6.14, 6.15, 6.16)

(1) Identify risks including relevant controls that relate to the risk of material misstatements or a risk of fraud;

(2) Assess whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;

(3) Assess whether the risk involves significant transactions with related parties;

(4) Assess the degree of subjectivity in the measurement of information related to the risk.

(5) Assess whether there arises a need for revising the assessment of risk based on additional audit evidence obtained.

5.6 Documentation: The auditor shall document:

(a) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 5.1 & 5.2 above and of each of the internal control components specified in paragraphs 5.3 above; the sources of information from which the understanding was obtained; and the risk assessment procedures performed;

(b) The identified and assessed risks of material misstatement at the cost statement level and at the assertion level including items of cost, cost heads and disclosure thereof as required by paragraph 5.5 above; and

(c) The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 5.5 above.

6. Application Guidance

6.1 Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous and dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the cost auditor plans the audit and exercises professional judgment throughout the audit, for example, when: (Refer 5.2)

(a) Assessing risks of material misstatement of the cost statements;



- (b) Considering the appropriateness of the selection and application of cost accounting policies, and the adequacy of cost statement disclosures;
 - (c) Identifying areas where special audit consideration may be necessary, for example, abnormal losses, lower yields, higher wastages, higher utilities consumption, related party transactions etc.
 - (d) Developing Models for use in performing analytical procedures;
 - (e) Responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence; and
 - (f) Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of management's oral and written representations.
- 6.2 Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments etc. Examples of matters the cost auditor may consider include: {Refer 5.2(b)}
- (a) The market and competition
 - (b) Cyclical or seasonal activity
 - (c) Changes in product technology
 - (d) Business risk (for example, high technology, high fashion, ease of entry for competition)
 - (e) Declining or expanding operations
 - (f) Adverse conditions (for example, declining demand, excess capacity, serious price competition)
 - (g) Key ratios and operating statistics
 - (h) Specific cost accounting practices and problems
 - (i) Specific or unique practices (for example, relating to labour contracts, financing methods, accounting methods).
 - (j) Energy supply sources and cost
 - (k) Environmental requirements and problems
- 6.3 An understanding of the entity's selection and application of cost accounting policies may encompass matters such as: {Refer 5.2(c)}
- (a) The methods the entity uses to account for significant and unusual transactions (abnormal events).
 - (b) The effect of significant cost accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.
 - (c) Changes in the entity's cost accounting policies.
 - (d) Cost reporting framework, and laws and regulations that are new to the entity and when and how the entity will adopt such requirements.
- 6.4 Management will measure and review those things they regard as important. Performance measures, whether external or internal, create pressures on the entity. These pressures, in turn, may motivate management to take action to improve the business performance or to misstate the cost or financial statements. Accordingly, an understanding of the entity's performance measures assists the cost auditor in considering whether pressures to achieve performance targets may result in management actions that increase the risks of material misstatement, including those due to fraud. Examples of internally-generated information used by management for measuring and reviewing financial performance, and which the cost auditor may consider, include: {Refer 5.2(d)}
- (a) Key performance indicators and key ratios (financial and non-financial).
 - (b) Key trends and operating statistics.

- (c) Period-on-period financial performance analyses.
 - (d) Budgets, forecasts, variance analyses, segment information and divisional, departmental or other unit level performance reports.
 - (e) Employee performance measures and incentive compensation policies.
 - (f) Comparisons of an entity's performance with that of competitors.
- 6.5 While understanding controls that are relevant to the audit, cost auditor should evaluate the design of those controls and determine whether they have been implemented properly, by performing procedures in addition to discussions with the entity's personnel. (Refer 5.3)
- 6.6 If the entity has established risk assessment process, the cost auditor should obtain an understanding of it, and the results thereof. If the cost auditor identifies risks of material misstatement that management failed to identify, the cost auditor should evaluate whether there was an underlying risk of a kind that the cost auditor expects would have been identified by the entity's risk assessment process. If there is such a risk, the cost auditor should obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or determine if there is a significant deficiency in internal control with regard to the entity's risk assessment process. {Refer 5.3(b)}
- 6.7 As part of the risk assessment, the cost auditor should determine whether any of the risks identified are, in the cost auditor's judgment, a significant risk. In exercising this judgment, the cost auditor should exclude the effects of identified controls related to the risk. {Refer 5.3(b)}
- 6.8 An understanding of the business risks facing the entity increases the likelihood of identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the cost statements. However, the cost auditor does not have a responsibility to identify or assess all business risks because not all business risks give rise to risks of material misstatement. {Refer 5.3(b)}
- 6.9 The cost auditor should understand the related cost accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred primarily to the accounting system and subsequently to cost accounting statement. {Refer 5.3(c)}
- 6.10 The cost auditor should obtain an understanding of control activities relevant to cost/ management information system in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions and disclosure in the cost statements or to every assertion relevant to them. {Refer 5.3(d)}
- 6.11 The cost auditor should obtain an understanding of the major activities that the entity uses to monitor internal control relevant to cost reporting, including those related to those control activities relevant to the audit, and how the entity initiates remedial actions to deficiencies in its controls. {Refer 5.3(e)(1)}
- 6.12 If an entity has an internal audit function, inquiries of the appropriate individuals within the function may provide information that is useful to the cost auditor in obtaining an understanding of the entity and its environment, and in identifying and assessing risks of material misstatement at the cost statement and assertion levels. If based on responses to the cost auditor's inquiries, it appears that there are findings that may be relevant to the entity's audit; the cost auditor may consider it appropriate to read related reports of the internal audit function. {Refer 5.3(e)(2)}
- 6.13 The cost auditor should assess the following with regard to IT environment and controls. (Refer 5.4)
- (a) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
 - (b) Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.



- (c) The possibility of IT personnel gaining access to privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
 - (d) Unauthorized changes to data in master files.
 - (e) Unauthorized changes to systems or programs.
 - (f) Failure to make necessary changes to systems or programs.
 - (g) Inappropriate manual interventions.
 - (h) Potential loss of data or inability to access data as required.
- 6.14 Risks at the cost statement level may derive in particular from a deficient control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as management's lack of competence may have a more pervasive effect on the cost statements and may require an overall response by the auditor. (Refer 5.5)
- 6.15 Risks of material misstatement at the cost statement level refer to risks that relate pervasively to the cost statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level, for example, through management override of internal control. Cost statement level risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud. (Refer 5.5)
- 6.16 The auditor's assessment of the identified risks at the assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion. (Refer 5.5)

7. Effective Date

This Standard is effective for audits on or after September 11, 2015.

The CAASB set the target and developed the following fifteen standards and these were sent by the Institute to the Ministry of Corporate Affairs (MCA) in the month of March 2016 for its approval:

SCA-105 Agreeing the Terms of Cost Audit Engagements

SCA-106 Audit Sampling

SCA-107 Audit Evidence

SCA-108 Materiality in Planning and Performing a Cost Audit

SCA-109 Cost Auditor's Responsibility relating to Fraud in an Audit of Cost Statements

SCA-110 Written Representations

SCA-111 Evaluation of Misstatements identified during the Cost Audit

SCA-112 Analytical Procedures

SCA-113 Using the work of internal Auditor

SCA-114 Using the Work of Cost Auditor's Expert

SCA-115 Communication with Those Charged with Governance

SCA-116 Communicating Deficiencies in Internal Control to Those charged with Governance and Management

SCA-117 Identifying and Assessing the Risks of Material Misstatement

SCA-118 The Cost Auditor's Responses to Assessed Risks

SCA-119 Related Parties

The mandatory application of these Standards in an audit of cost records shall come in force after approval of the Central Government and notification by the Institute of Cost Accountants of India.

Study Note - 6

FILING OF COST AUDIT REPORT TO MCA [In XBRL Format (as per TAXONOMY)]



This Study Note includes

- 6.1 Introduction
- 6.2 Glossary of XBRL Terms
- 6.3 Filing Cost Audit Report in XBRL Format on MCA Portal
- 6.4 XBRL Conversion and Filing errors and interpretation

6.1 INTRODUCTION

As already studied in the Chapter-2, Rule 6(6), of the Companies (Cost Records and Audit) Rules, 2014, as amended by the Companies (Cost Records and Audit) Amendment Rules, 2016, vide Gazette notification No: G.S.R. 695(E), dated 14th July, 2016 mandates that:

“Every company covered under these rules 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 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 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.”.

Accordingly, all the cost audit reports have to be filed online, with MCA, in XBRL format, attached to the prescribed Form- CRA-4. XBRL international, and the MCA portal, provide detailed information about XBRL and its applications. The necessary information and procedure for understanding XBRL in general and filing of cost audit report in that format, as extracted from these portals is briefly recited below:

XBRL is the open international standard for digital business reporting, managed by a global not for profit consortium called “XBRL International”. XBRL is used around the world, in more than 50 countries. Millions of XBRL documents are created every year, replacing older, paper-based reports with more useful, more effective and more accurate digital versions. The change from paper, PDF and HTML based reports to XBRL is like the change from film photography to digital photography, or from paper maps to digital maps.

XBRL makes reporting more accurate and more efficient. It allows unique tags to be associated with reported facts, allowing:

- people publishing reports to do so with confidence that the information contained in them can be consumed and analysed accurately
- people consuming reports to test them against a set of business and logical rules, in order to capture and avoid mistakes at their source
- people using the information to do so in the way that best suits their needs, including by using different languages, alternative currencies and in their preferred style
- people consuming the information to do so confident that the data provided to them conforms to a set of sophisticated pre-defined definitions

Comprehensive definitions and accurate data tags allow the:

- preparation
- validation

- publication
- exchange
- consumption; and
- analysis

of business information of all kinds.

Information in reports prepared using the XBRL standard is interchangeable between different information systems in entirely different organisations. This allows for the exchange of business information across a reporting chain. People that want to report information, share information, publish performance information and allow straight through information processing all rely on XBRL.

6.2 GLOSSARY OF XBRL TERMS

XBRL Glossary: Several technical terms are used, that have specific meanings, in the context of using XBRL. They are listed below:

Abstract: An attribute of an element to indicate that the element is only used in a hierarchy to group related elements together. An abstract element cannot be used to tag data in an instance document.

Attribute: A property of an element such as its name, balance, data type, and whether the element is abstract.

Authoritative reference: Citations to specific authoritative accounting literature (pronouncements, standards, rules, and regulations) derived from various authoritative sources (Securities and Exchange Commission, Financial Accounting Standards Board, American Institute of Certified Public Accountants, etc.) and used to help define an element.

Axis (pl. **axes**): An instance document contains facts; an axis differentiates facts and each axis represents a way that the facts may be classified. For example, Revenue for a period might be reported along a business unit axis, a country axis, a product axis, and so forth.

Axis-default relationship: The dimensional relationship indicating that the table axis has a default domain member. In the XBRL US GAAP Taxonomies 1.0, the default is always the domain element.

Axis-domain relationship: The dimensional relationship indicating that the table axis has members drawn from a domain.

Balance: An attribute of a monetary item type designated as debit, credit, or neither; a designation, if any, should be the natural or most expected balance of the element – credit or debit – and thus indicates how calculation relationships involving the element may be assigned a weight attribute (-1 or +1).

Calculation relationships: Additive relationships between numeric items expressed as parent-child hierarchies.

Concept: XBRL technical term for element.

Context: Entity and report-specific information (reporting period, segment information, and so forth) required by XBRL that allows tagged data to be understood in relation to other information.

Decimal: Instance document fact attribute used to express the number of decimal places to which numbers have been rounded.

Definition relationships file: Technical term for dimensional relationships file

Dimension: XBRL technical term for axis.

Domain: An element that represents an entire set of other elements; the domain and its members are used to classify facts along the axis of a table. For example, and would be used to classify elements such as revenues and assets in as distinct from other states. When a fact does not have any domain member specified, that means it applies to the entire domain.



Domain member: An element representing one of the possibilities within a domain.

Domain-member relationship: Dimensional relationship indicating that a domain contains the member.

Element: XBRL components (items, domain members, dimensions, and so forth). The representation of a financial reporting concept, including: line items in the face of the financial statements, important narrative disclosures, and rows and columns in tables.

Element definition: A human-readable description of a reporting concept. From an XBRL technical point of view, the element definition is the label with the type "documentation," and there are label relationships in a label relationships file, but from a user point of view the definition is an unchangeable attribute of the element.

The Number of elements in the cost audit report, both substitution-group wise and data-type wise are as follows:

Number of elements- Substitution-group wise:

Substitution group	Count
xbrli:item	452
xbrldt:hypercubeItem	18
xbrldt:dimensionItem	15
Total	485

Number of elements-Data type wise

Row Labels	Count of Element Name
nonnum:domainItemType	47
nonnum:textBlockItemType	48
num:percentItemType	6
in-cost-type:CategoryOfCostAccountant	2
in-cost-type:TypeOfSector	1
in-cost-type:NatureOfEmploymentOfCostAccountant	1
in-cost-type:BasisAdoptedToDetermineNormalPriceOfRelatedPartyTransactions	1
in-cost-type:LevelOfRounding	1
in-cost-type:NatureOfMaterialConsumed	1
In-cost-type:CINNumberItemType	1
in-cost-type:PermanentAccountNumber	3
in-cost-type:ProductGroupCode	3
in-cost-type:SubheadingCodeLength	2
in-cost-type:ServiceCode	1
xbrli:booleanItemType	7
xbrli:dateItemType	9
xbrli:decimalItemType	85
xbrli:monetaryItemType	116
xbrli:IntegerItemType	1
xbrli: nonNegativeIntegerItemType	2
xbrli:stringItemType	142
xbrli:pureItemType	5
Total	485

Extension taxonomy or extension: A taxonomy that allows users to add to a published taxonomy in order to define new elements or change element relationships and attributes (presentation, calculation, labels, and so forth) without altering the original.

Face of the financial statements: Financial statements without the notes or schedules.

Fact: The occurrence in an instance document of a value or other information tagged by a taxonomy element.

Hierarchy: Trees (presentation, calculation, and so forth) used to express and navigate relationships.

Hypercube: XBRL technical term for a table.

Imputed value: A value that is not specifically provided but could be calculated based on other provided numbers and calculation weights.

Instance or instance document: XML file that contains business reporting information and represents a collection of financial facts and report-specific information using tags from one or more XBRL taxonomies.

Item: XBRL technical term for a kind of element.

Label: Human-readable name for an element; each element has a standard label that corresponds to the element name, and is unique across the taxonomy.

Label type: A distinguishing name for each distinct element indicating the circumstances in which it should be used; each is given a separate defining role to use in different presentation situations.

Line item: Elements that conventionally appear on the vertical axis (rows) of a table.

Link base: XBRL technical term for a relationships file. Only the ELRs which have dimensional relationships are included in definition linkbase. The List of ELR definitions in Cost Audit Report are shown below:

Extended Link Role definition	Used on
[100100] General information	presentation Link base Ref
[100300] General details of cost auditor	presentationLinkbaseRef, definitionLinkbaseRef
[100300a] General details of cost auditor for period prior to 01-APR-2014	presentationLinkbaseRef, definitionLinkbaseRef
[100310] Cost accounting policy	presentationLinkbaseRef
[100320] Manufactured product or service	presentationLinkbaseRef, calculationLinkbaseRef, definitionLinkbaseRef
[100330] Quantitative information of manufactured product	presentationLinkbaseRef, calculationLinkbaseRef, definitionLinkbaseRef
[100340] Abridged cost statement of manufactured product	presentationLinkbaseRef, calculationLinkbaseRef, definitionLinkbaseRef
[100340a] Abridged cost statement-Details of material consumed	presentationLinkbaseRef definitionLinkbaseRef
[100340b] Abridged cost statement-Details of utilities	presentationLinkbaseRef, definitionLinkbaseRef
[100340c] Abridged cost statement-Details of industry specific operating expenses	presentationLinkbaseRef, definitionLinkbaseRef
[100341] Quantitative information of service	presentationLinkbaseRef, calculationLinkbaseRef, definitionLinkbaseRef
[100342] Abridged cost statement of service	presentationLinkbaseRef, calculationLinkbaseRef, definitionLinkbaseRef



[100342a] Abridged cost statement-Details of material consumed	presentationLinkbaseRef, definitionLinkbaseRef
[100342b] Abridged cost statement-Details of utilities	presentationLinkbaseRef, definitionLinkbaseRef
[100342c] Abridged cost statement-Details of industry specific operating expenses	presentationLinkbaseRef, definitionLinkbaseRef
[100350] Product and service profitability statement of manufactured product or service	presentationLinkbaseRef, definitionLinkbaseRef
[100360] Profit reconciliation	presentationLinkbaseRef, calculationLinkbaseRef
[100360a] Profit reconciliation-Details of incomes not considered	presentationLinkbaseRef, definitionLinkbaseRef
[100360b] Profit reconciliation-Details of expenses not considered	presentationLinkbaseRef, definitionLinkbaseRef
[100370] Value addition and distribution of earnings	presentationLinkbaseRef, calculationLinkbaseRef
[100400] Financial position and ratio analysis	presentationLinkbaseRef, calculationLinkbaseRef
[100410] Related party transactions	presentationLinkbaseRef, definitionLinkbaseRef
[100420] Reconciliation of indirect taxes	presentationLinkbaseRef, calculationLinkbaseRef, definitionLinkbaseRef
[100421] Reconciliation of indirect taxes/not-all	definitionLinkbaseRef
[100421a] Reconciliation of indirect taxes/not-all	definitionLinkbaseRef
[100421b] Reconciliation of indirect taxes/not-all	definitionLinkbaseRef
[100421c] Reconciliation of indirect taxes/not-all	definitionLinkbaseRef
[100421d] Reconciliation of indirect taxes/not-all	definitionLinkbaseRef
[900000] Typed default	definitionLinkbaseRef
[910000] Axis-Defaults	definitionLinkbaseRef

The following is the summary of Extended link rolesUsed in linkbase in Cost Audit Report:

Presentation	23
Calculation	9
Definition	23

Mapping: Process of determining the elements that correspond to lines and columns in a financial statement and which elements must be created by extension.

Name: Unique identifier of an element in a taxonomy.

Namespace: Every element has a Universal Resource Identifier (URI) that identifies the organization that maintains the element definitions, with an indication of what the term covers. In the XBRL US GAAP Taxonomy, namespaces start with *http://xbrl.us/us-gaap*. A namespace prefix is not the namespace.

Nillable: An attribute that appears on all taxonomy elements, and is used (false) on elements that, if used in an instance document, must have a non-empty value. XBRL taxonomy tools normally have the default value for nillable as "true." There is no need for any extension to define an element with nillable "false."

Not all: Is used where it is required to freeze the cells in a dimensional table. It restricts inputting of values for certain combinations of primary elements and dimension members in the dimension table.

E.g. In Para D-6 – Reconciliation of Indirect Taxes, entry of data would be allowed to against only those elements where there is symbol 'x' in that table, as follows:

Reconciliation Of Indirect Taxes					
					INR
Particulars	Assessable Value	Excise duty	Service tax	Cess and others	Value added tax
Total clearances of company					
Excise duty payable for domestic clearances	x	x		x	
Excise duty payable for export clearances	x	x		x	
Excise duty payable on stock transfers	x	x		x	
Excise duty payable on other clearances	x	x		x	
Total excise duty payable by company					
Service tax payable by company	x		x	X	
Value added tax and central sales tax payable by company					X
Other state taxes payable by company					X
Total duties taxes payable by company					
Duties taxes paid by company [abstract]					
Cenvatutilised [abstract]					
Input credits utilized		x	x	x	x
Capital goods credits utilized		x		x	
Input services credits utilized		x	x	x	
Other credits utilized		x	x	x	X
Total credits utilised by company					
Indirect taxes paid through PLA or cash		x	x	X	X
Duties taxes paid by company					
Duties taxes recovered by company		x	x	X	X
Difference between duties taxes paid and recovered					X
Interest penalty fines paid by company		x	x	X	X
Notes to reconciliation of indirect taxes [text block]	Add Text Block	Add Text Block	Add Text Block	Add Text Block	Add Text Block

Parent-child hierarchy: Relationship between elements that indicates subordination of one to the other as represented in a print listing or financial statement presentation. Relationships files use parent-child hierarchies to model several different relationships, including presentation, summation of a set of facts, and membership of concepts within a domain used as the axis of a table.

Period type: An attribute of an element that reflects whether it is reported as an instant or duration time period.

Prefix/namespace prefix: A shorthand sequence of letters for a namespace; "us-gaap," for example, is a common prefix for the namespace <http://xbrl.us/us-gaap/2008-01-31>.

Presentation relationships: Relationships that arrange elements allowing them to navigate the taxonomy content in parent-child tree structures (hierarchies).

Render/rendering: To process an instance document into a layout that facilitates readability and understanding of its contents.



Scaling: A process that automatically scales numeric data by value, thus saving time of entering zeros during the entry or creation process. XBRL does not support the scaling of numeric values (all values must be reported in their entirety); however, it is a feature commonly found in instance document creation software.

Scenario: Tag that allows for additional information to be associated with facts in an instance document; this information encompasses in particular the reporting circumstances of the fact, as for example "actual or forecast." The scenario of any fact can be left unspecified.

Schema: Technical term for an element declaration file.

Segment: Tag that allows additional information to be included in the context of an instance document; this information captures segment information such as an entity's business units, type of debt, type of other income, and so forth.

Sign value: Denotes whether a numeric fact in an instance has a positive (+) or negative (-) value.

Standard label: The default label for an element. An extension may override the standard label.

Table: An element that organizes a set of axes and a set of line items to indicate that each fact of one of the line items could be further characterized along one or more of its axes. For example, if a line item is Sales and an axis is Scenario, this means that an instance document could have facts that are either for an unspecified scenario or for a specific scenario such as "actual or forecast."

Tag (noun): Identifying information that describes a unit of data in an instance document and encloses it in angle brackets (<> and). All facts in an instance document are enclosed by tags that identify the element of the fact.

Tag (verb): To apply tags to an instance document.

Taxonomy, taxonomies: Electronic dictionary of business reporting elements used to report business data. A taxonomy is composed of an element names file (.xsd) and relationships files directly referenced by that schema. The taxonomy schema files together with the relationships files define the concepts (elements) and relationships that form the basis of the taxonomy. The set of related schemas and relationships files altogether constitute a taxonomy.

Type or data type: Data types (monetary, string, share, decimal, and so forth) define the kind of data to be tagged with the element name.

E.g. the List of new data types defined for para 2 of the annexure to the cost audit report, in respect of the details of cost auditor(s), will be as follows:

#	Data type	Enumerations/Restrictions
1	Category Of Cost Accountant	Firm, Sole Proprietor
2	Nature Of Employment Of Cost Accountant	In Employment, In Practice
3	Type Of Sector	Manufactured product, Service
4	Basis Adopted To Determine Normal Price Of Related Party Transactions	Comparable uncontrolled price method, Resale price method, Cost plus method, Profit split method, Transactional net margin method, Any other method
5	Level Of Rounding	Actual , Thousands , Lakhs, Millions , Crores, Billions
6	Nature Of Material Consumed	Indigenous purchased, Imported, Self-manufactured or produced
7	CIN Number Item Type	Length = 21
8	SRN Number	Length=9, pattern restriction= [A-Z][0-9][0-9][0-9][0-9][0-9][0-9][0-9][0-9] e.g.A12345678
9	Permanent Account Number	Length=10, pattern restriction=[A-Z][A-Z][A-Z][A-Z][A-Z][0-9][0-9][0-9][0-9][A-Z] e.g.AKGH11234T
10	Product Group Code	Length=4, pattern restriction= [0-9][0-9][0-9][0-9] e.g. 1234
11	Service Code	Maximum Length=6, pattern restriction= [0-9][0-9][0-9][0-9][0-9][0-9] e.g. 432101, 12351 etc.
12	Sub heading Code Length	Maximum Length =4

Unit of measure: The units in which numeric items have been measured, such as dollars, shares, Euros, or dollars per share.

Validation: Process of checking that instance documents and taxonomies correctly meet the rules of the XBRL specification.

Weight: Calculation relationship attribute (-1 or +1) that works in conjunction with the balance of the parent and child numeric elements to determine the arithmetic summation relationship.

6.3 FILING COST AUDIT REPORT IN XBRL FORMAT ON MCA PORTAL

A. System requirements for MCA21 XBRL Validator Tool for Costing Taxonomy 2015:

The following is the system requirement for using the MCA21 XBRL validator tool:

(1) Operating System : Windows XP/Windows Vista/Windows 7

Minimum 2 GB of RAM & minimum 20 MB free space

Processor Speed of 1GHz

Java Environment : JRE version 1.6 or 1.7

(2) Version

This is version 2.0.1 of the MCA21 XBRL Validator Tool for Costing Taxonomy 2015.

(3) How to run the tool?:

(a) Double click on extracted executable file 'XBRLTool.exe'

(b) Select the 'Download Taxonomy' under Taxonomy Option

(c) Once downloaded, select downloaded taxonomy from the 'Select Taxonomy' option under 'Taxonomy' menu.

(d) Open the XBRL instance document under File.

The language in tool can be changed from "Change Language" Option under Taxonomy (Default Language: English).

B. Steps for filing Cost Audit report in XBRL format on MCA portal:

1. Creation of XBRL instance document

The first step for creating the instance document is tagging of the XBRL taxonomy elements with the information in the Cost audit report of the company by means of mapping of the taxonomy elements with the Cost audit report. This converts the report into XBRL form. We need to have a tool to create an xml file and convert it into an instance document. There are several vendors, who provide and sell this application, that has to be acquired for the purpose.

Mapping is the process of comparing the concepts in the Cost audit report to the elements in the published taxonomy, assigning a taxonomy element to each costing concept published by the company. Once the tagging of Cost audit report/ compliance report elements with the published taxonomy elements is done, the next step is to create the instance document. An instance document is a XML file that contains business reporting information and represents a collection of costing information and report-specific information using tags from the XBRL taxonomy. It is to be noted that no extensions to the core Taxonomy will be allowed. Separate instance documents need to be created for the Cost Audit report, for the periods prior to and beginning after 1.04.2014.

Once the instance document has been prepared, it needs to be ensured that the instance document is a valid instance document and all the information has been correctly captured in the instance document. MCA Validation Tool provides for 'human readable' PDF printable form as well as a view of the instance document.



2. Download XBRL validation tool

A separate tool has been provided on the MCA XBRL portal for validating the generated XBRL instance document. Validating the instance document with the MCA XBRL validation tool (for costing taxonomy) is a pre-requisite before filing the Cost audit report and Compliance report on MCA portal.

You are required to download the tool from the portal and validate the instance document before uploading the same. The MCA XBRL validation tool (for costing taxonomy) can be downloaded from the XBRL website of the Ministry (www.mca.gov.in/XBRL).

Before Validating an Instance document, the applicable taxonomy is to be selected by the user from the drop down option "taxonomy". In case the user is under LAN network, then he/she is required to click the link 'Proxy Settings' under 'Taxonomy' menu in the tool to enter the Proxy Host and Port along with user name and password. This is to setup the Internet connection, required to download the taxonomy through the XBRL Validation Tool.

3. Load the instance document

To load the instance document, you need to click the open button, select the instance document and open it. You need not exit the tool to load another instance document just click on 'open' again in the menu bar to open the next document. The detail of the company is available under the General Information tag in the XBRL viewer.

4. Validate the instance document

The next step is to validate the instance document. The following validations shall be performed by the tool-

- Validating that the instance document is as per the latest and correct version of taxonomy prescribed by MCA
- All mandatory elements have been entered
- Business Rules as specified by MCA
- Validations relating to XBRL technical Specifications as per taxonomy

In case the instance document is not properly created, then the tool will through up the list of errors, in a separate window, and they need to be corrected and validated again for successful uploading of the report. The List of common errors and interpretation of validation errors as provided in Annexures –I & II, which are given at the end of this chapter.

5. Pre-scrutiny of the instance document

Once the instance document is successfully validated from the tool, the next step is to pre-scrutinise the validated instance document with the help of the same tool using a working internet connection. In the Pre-scrutiny, the server side validations (i.e. validations which are to be validated from the MCA21 system) shall be performed, using the MCA21 data base

6. Convert to PDF and verify the contents of the instance document.

Once the instance document has been successfully pre-scrutinized, the next step is to generate PDF by using 'Export to PDF' functionality in the tool to verify the final instance document. This step is essential to ensure that the textual information entered in the instance document is clearly readable. The company and the cost auditor/ cost accountant can use this feature to verify the accuracy of the instance document.

In case there is PDF conversion error or the size of the converted PDF is zero kilobytes, then check the textual information entered in the instance document and follow the html guidelines provided under the technical specifications to correct the instance document and validate and pre-scrutinize again.

7. Attach instance document to the Form CRA-4

Form CRA-4 is available on the MCA portal for filing in XBRL instance documents by the Company. First the Form has to be filled up correctly and thereafter, the validated and pre-scrutinised instance document for Cost Audit Report has to be attached to Form CRA-4.

8. Submitting the Form CRA-4 on the MCA portal.

After the form is correctly filled, it is required to pre-scrutinize and then sign the form [with a valid digital signature of the person authorized by the board resolution] and then upload the same as per the normal e-Form filing process.

6.4 XBRL CONVERSION AND FILING ERRORS AND INTERPRETATION

Once the validation has been performed the list of errors, which may have occurred will be displayed by the tool. An "error" indicates that a mistake has happened, either in respect of the value of an item, or the format in which the value of the item is to be entered, not the value of an item, not matching with the values as in the data base of the MCA. E.g.: Date format 10-05-2016 is not the correct format, and it has to be entered as 10/05/2016

A. List of common errors [Annexure – II]

Following are the few errors that may crop up in the process:

(1) Issue in net connectivity. Please check your connection:

In case the user is under LAN network, then it is required to click the link 'Proxy Settings' under 'Taxonomy' menu in the tool to enter the Proxy Host and Port along with user name and password. This is to setup the Internet connection, required to download the taxonomy through the XBRL Validation Tool.

(2) The PDF is not getting generated or PDF generated is of zero kilobytes in size.

For example: Error creating PDF. In that case, we have to check the textual information entered in the instance document and follow the html guidelines provided in section 1.1.3.1 point no. 38 technical specifications to correct the instance document and validate and pre-scrutinize again

(3) The format of the date entered is not as per the valid format.

For example: cvc-datatype-valid.1.2.1: '01-04-2011' is not a valid value for 'date'. Then it should be ensured that the date format is in 'yyyy-mm-dd'.

(4) For Boolean data types 'Yes' or 'No' has been entered.

For example: cvc-datatype-valid.1.2.1: 'yes' is not a valid value for 'boolean'. Only 'True' or 'False' can be entered for Boolean Data Type

(5) 0-100 entered for Percentage Data Type fields

For example: RatioOfOperatingExpenses should be less than equal to 100%. Only value between 0-1 needs to be entered. For example to report 60 % as value you need to enter 0.6 in the field.

(6) Wrong Currency code like Rs entered.

For example: cvc-id.1: There is no ID/IDREF binding for IDREF 'Rs.

- No valid unit specified for monetary item {http://www.icwai.org/in/xbrl/2012-09-07/in-cost} Net Operational Revenue Of Product Or Activity Group
- No unit defined for unit id Rs
- Invalid unit specified for monetary item {http://www.icwai.org/in/xbrl/2012-09-07/in-cost} Net Operational Revenue Of Product Or Activity Group
- Reporting currency should be in INR for –'Net Operational Revenue Of Product Or Activity Group'. For Indian Currency 'INR' needs to be entered.

(7) Mandatory fields have not been entered.

For example: Element— 'NetRevenueFromOperationsOfCompanyForValueAddition' is required - Not present for date: 31/03/2012 Refer Taxonomy and Business Rules for the list of mandatory elements.



- (8) For Cost accounting taxonomy for F.Y. 2011-12, if the following error appears – “Element ‘DateOfStartOfFirstPreviousFinancialYear’ is not present - Required, since element ‘DateOfEndOfFirstPreviousFinancialYear’ is present for date: 31/03/2012”.**

In extended link role [100100] General information, in case the element – “DateOfEndOfFirstPreviousFinancialYear” is provided, then you are required to provide the value of ‘DateOfStartOfFirstPreviousFinancialYear’ and vice-a-versa.

- (9) In case the mandatory line-items of a table are not entered in the instance document.**

- For example: DetailsOfCostAuditorTable{<http://www.icwai.org/in/xbrl/2012-09-07/in—costaud/role/CostAuditReportFormII>} mandatory items
- [‘DisclosureRelatingToAvailabilityOfCostRecordsOfBranchesNotVisitedExplanatory’ ,
- ‘CostAuditorsObservationsOrSuggestionsExplanatory’] should be present for typed member: {DetailsOfCostAuditor1} for date : 31/03/2012

The element(s) mentioned in square bracket should be present for all the mentioned typed members (explicit members in case the error is for explicit member).

- (10) The elements are not entered for any abstract.**

- For example: All the elements of ‘CostAccountingPolicyAbstract’ are mandatory - Required for date: 31/03/2012.

The elements which come under this abstract should be provided. Please refer Taxonomy and Business Rules for the list of elements under this abstract.

- (11) The elements are not entered for ordered explicit members.**

- For example: Explicit members on axis
(DetailsOfMaterialConsumedOfProductGroupAxis)—of table
- DetailsOfMaterialConsumedOfProductGroupTable should be present in sequential order , item(s) for the members { MaterialConsumed3Member }—should be present for date: 201103-31.

The element should be present for the mentioned explicit member(s). For ordering refer to the presentation linkbase.

- (12) In case of mandatory table, there is no element present.**

- For example: Item(s) for TypesOfIndirectTaxesOfCompanyTable—{<http://www.icwai.org/in/xbrl/2012-09-07/in-cost-aud/role/ReconciliationOfIndirectTaxes>} should be present For Period 2011-04-01 to 2012-03-31

At least one of the elements of the table should be present for one of the explicit members.

- (13) The value of element should be provided in at least one of the dimensional member.**

- For example: Value of element— ‘WhetherProductOrActivityGroupCoveredUnderCostAudit’ should be ‘true’ for at least one dimensional member.

The value for given element should be selected “true” in at least one of all dimensional members in which it is present .Please refer taxonomy and business specifications for such elements and corresponding values.

- (14) All details for given product or activity group code should be provided.**

- For example: All details of applicable ProductOrActivityGroupCode [1009]— are required for previous year on role ‘[100340] Abridged cost statement of product or activity group’.

In this case provide the details of product or activity group code which is specified for corresponding ELR’s which are specified in the error statement.

(15) An element having dimensional relationship is invalid with respect to scenario element in the referenced context.

- For example: item {<http://www.icwai.org/in/xbrl/2012-09-07/incost>} DisclosureRelatingToAdequacyOfInternalAuditOfCostRecordsExplanatory in context D2012— does not have any valid hypercube set in any role.

The scenario element must be dimensionally valid for at least one definition base set for that element.

All the references to dimensions and dimensional values in scenario element should be as per taxonomy including namespaces. It should not contain any combination of dimension values which are excluded by notAll relationship defined for that element.

It should not contain reference to default dimension value. It should not contain reference to dimension values whose usable attribute is set as false in taxonomy (Freezed).

B. Interpretation of validation errors [Annexure – I]

The following the instructions have to be followed to interpret those errors –

- All the Element Names will be shown within single quotes, like-'QuantityOfMaterialConsumed'
- All the values will be shown within square brackets like- [In Employment]
- All the explicit members must come within curly brackets like-{MaterialConsumed1Member}
- All the axis names will be shown within parenthesis like-(IdentificationOfProductOrActivityGroupAxis)
- Errors which start with "cvc" are those which have occurred for the reason that the instance document generated is not as per valid taxonomy schema and the XML is not properly formed.

This is a basic level error and the software vendor needs to be contacted for these errors like- cvc-complex-type.2.2. [The schema validator used is Xerces from Apache (<http://xerces.apache.org/>) which is Industry Standard Schema Validator]

- In case of Costing Taxonomy 2012, in some of the errors you might see terms like- "table", "axis", "explicit-members" and "typed-members".

The same has been explained below for better understanding:

- Table (Hypercube)-is a collection of axes (dimensions) when grouped together define an entity.
- Axis (Dimension) - is a category used to analyze the information about the items having relationship with a table.
- Explicit-members- are domains that are used to express an explicit dimension. It is an element defined in the taxonomy.
- Typed-members- are domains that are used to express a typed dimension. The dimension value for simple type domain is decided by the user creating instance document.

For example,

- The item 'QuantityOfMaterialConsumed' –has a table 'DetailsOfMaterialConsumedOfProductGroupTable'—is described by an axis 'DetailsOfMaterialConsumedOfProductGroupAxis'—This axis is further expressed by explicit-members such as-'MaterialConsumed1Member', 'MaterialConsumed2Member' etc.
- The item 'UnitOfMeasurementForProductOrActivityGroup' –has a table 'ProductOrActivityGroupTable' which is described by an axis 'IdentificationOfProductOrActivityGroupAxis'.—This axis is further expressed by a typeddomain 'ProductOrActivityGroupDomain'—which is a simple type domain whose value is decided by the user preparing the instance document.



In case warning messages are displayed, these are in respect of non-compliance to HTML guidelines. You should convert the instance documents into PDF through the validation tool and verify the contents of the same. However the warning messages will not disallow the pre-scrutiny through validation tool.

Various screen shots of cost XBRL sheets are given below.

(a) COMPANY MASTER

Company Master

Company
* Company Identification Number (CIN)/Foreign company Regn. No of company [] [Pre-Fill]

Indian Company Foreign Company

Global location number (GLN) []

* Company Name [] Type Of Company []

* Display Name [] Company PAN []

* Principal place of business for foreign company [] * Login Id []

* Password []

Confirm Password []

Registered office Address

Line1 [] Line2 []

City [] District []

* State [--Please Select--] Pin Code []

Country [INDIA] * e-mail []

Is registered office address and corporate office address are same

Corporate office Address

Line1 [] Line2 []

City [] District []

State [--Please Select--] Pin Code []

Country [INDIA] * e-mail []

Note: Principal place of business is required in case of foreign company

[Save] [Close]

(b) AUDITOR MASTER

Auditor Master

* Auditor/Auditor's Firm Name []

* Display Name []

Auditor Category
 Sole Proprietor Cost Accountant's Firm In Employment
 LLP

* Firm's Registration Number []

* Auditor/Auditor's Firm PAN []

Details of member signing report

* Name []

* Membership Number []

Whether Cost Auditor is lead Auditor Yes No

Address

* Line1 []

Line2 []

District []

* City []

* State [--Please Select--]

Country [INDIA]

* e-Mail []

* Pin Code []

Phone []

Auditor Name	Membership	PAN
S.S.SONTHALIA & CO.	1021168	ABSPS3867Q

Search [] [Delete]

[Import Auditor from other Company] [Clear] [Save] [Close]

Cost and Management Audit

c) PART A-4 - PRODUCT DETAILS

WEB-Cost-XBRL [Version 4.7] (Comp3) | Financial Year 2015-2016 - [PRODUCT/SERVICE DETAILS]

Financial Year : 2015-16
Level of Roundings : Millions

Part A-4. PRODUCT/SERVICE DETAILS (for the company as a whole) (Earlier Para-3)

Sector Type	Name of Product or Service	CETA Code	Multiple Sub-heading CETA Code for same Product/ Service(Y/N)	Sub-heading of CETA Code	Multiple UOM for same Product/ Service(Y/N)	UOM	Covered under cost Audit for Current Year	Previous Year figure reported (Y/N)	Reason, if Prv. year figure not reported	Net Operational Revenue (2015-16)	Net Operational Revenue (2014-15)
Product	Iron Ore	2601	No		No	MT	Yes	Yes	Give Reason	2633.02	370.94
Product	Pig Iron	7201	No	1000	No	MT	Yes	Yes	Give Reason	2098.83	4980.95
Product	Pig Iron Scrap	7204	No	1000	No	MT	Yes	Yes	Give Reason	116.73	213.7
	Other Operating Incomes									0	0
	Total operating incomes of company									4848.58	5565.59
	Other Incomes of Company									164.25	830.91
	Total revenue as per Financial Accounts									5012.83	6396.5
	Extra Ordinary Income									0	0
	Total Revenue including Extra Ordinary Income									5012.83	6396.5
	Turnover as per Excise/Service Tax Records									2321.93	5091.53

Press Right Click to delete selected row and Add Footnote
Press Ctrl+F to Add Footnote

* Note: For (Other Operating Incomes, Total Net Revenue from Operations, Other Incomes of Company, Total Revenue as per Financial Accounts, Extra Ordinary Income, Total Revenue including Extra Ordinary Income, Turnover as per Excise/Service Tax Records) only Net Operational Revenue is required.

Print Save Close

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d) PART B-1 - QUANTITATIVE INFORMATION

WEB-Cost-XBRL [Version 4.7] (Comp3) | Financial Year 2015-2016 - [Quantitative Information]

Financial Year : 2015-16
Level of Roundings : Millions

Unit of Measurement

Name of Product/Service: --Select--

Particulars	2015-16	2014-15
1. Available Capacity		
(a) Installed capacity on start of reporting period		
(b) Capacity enhanced during reporting period		
(c) Capacity available through leasing arrangements		
(d) Capacity available through loan license or third parties		
(e) Total available Capacity	0.000	0.000
2. Actual production		
(a) Quantity self manufactured		
(b) Quantity produced under leasing arrangements		
(c) Quantity produced on loan license or by third parties on job work		
(d) Total actual production quantity	0.000	0.000
3. Production as per excise records		
4. In house capacity utilization (%)		
5. Finished goods purchased		
(a) Domestic purchase of finished goods		
(b) Imports of finished goods		
(c) Total finished goods purchased	0.000	0.000
6. Stock and other adjustments		
(a) Change in stock of finished goods		
(b) Self or captive consumption including samples		
(c) Other quantitative adjustments		
(d) Total stock and other adjustments	0.000	0.000
7. Available quantity for sale	0.000	0.000
8. Actual sales		
(a) Domestic sales of manufactured products		
(b) Domestic sales of traded products		
(c) Export sale of manufactured products		
(d) Export sale of traded products		
(e) Total quantity sold of manufactured and traded product	0.000	0.000

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e) PART B-2 - ABRIDGED COST STATEMENT

WEB-Cost-XBRL [Version 4.7] [Comp3] | Financial Year 2015-2016 - [Abridged Cost Statement]

Financial Year: 2015-16
Level of Roundings : Millions

Name of Product/Service: --Select--

Particulars	2015-16		2014-15	
	Amount	Rate per Unit	Amount	Rate per Unit
1. Materials Consumed				
2. Process Materials/ Chemicals				
3. Utilities consumed				
4. Direct Employees Cost				
5. Direct Expenses				
6. Consumable Stores & Spares				
7. Repairs & Maintenance				
8. Quality Control Expenses				
9. Research & Development Expenses				
10. Technical know-how Fee / Royalty, if any				
11. Depreciation/Amortization				
12. Other Production Overheads				
13. Industry specific elements of operating expenses				
14. Total of inputs and conversion cost	0.00	0.00	0.00	0.00
15. Increase (decrease) in work-in-progress				
16. Credits for recoveries				
17. Primary packing cost				
18. Cost of production or operations	0.00	0.00	0.00	0.00
19. Cost of finished goods purchased				
20. Total cost of production and purchases	0.00		0.00	
21. Cost of increase/decrease in finished goods				
22. Cost of self or captive consumption				
23. Cost of other adjustments				
24. Cost of production or operation of Product sold	0.00		0.00	
25. Cost of administrative overheads				
26. Cost of secondary packing				
27. Cost of selling and distribution overheads				
28. Cost of Sales before Interest (24 to 27)	0.00	0.00	0.00	0.00
29. Cost of interest and financing charges				
30. Cost of sales of product	0.00	0.00	0.00	0.00
31. Net sales realization of product				
32. Amount of margin as per cost accounts	0.00	0.00	0.00	0.00

Below data comes from Quantitative Information

Unit of measurement: MT

Product	2015-2016	2014-15
Actual production quantity	1659792.00	190608.00
Finished goods purchased	0.00	0.00
Change in stock of finished goods	297679.00	270420.00
Self or captive consumption	185747.00	309525.00
Other quantitative adjustments	0.00	0.00
Total stock and other adjustments	111932.00	-39105.00
Total quantity sold	1771724.00	151503.00

Press Ctrl+F to Add Footnote

Buttons: Load Previous Year Data, Print, Material Consumed, Utility, Industry Specific, Export to excel, Save, Close

f) PART B-2 (a) MATERIAL DETAILS

WEB-Cost-XBRL [Version 4.7] [Comp3] | Financial Year 2015-2016 - [Details of Material Consumed]

Financial Year: 2015-16
Level of Roundings : Millions

Unit of Measurement: [Select]

Name of Product / Service: --Select--

Particulars	Description	Nature	Unit	2015-16			2014-15		
				Quantity	Rate	Amount	Quantity	Rate	Amount
Material consumed 1									
Material consumed 2									
Material consumed 3									
Material consumed 4									
Material consumed 5									
Material consumed 6									
Material consumed 7									
Material consumed 8									
Material consumed 9									
Material consumed 10									
Total						0.00			0.00
Material Consumed as per Abridged Cost Statement						0.00			0.00
Difference						0.00			0.00

Press Ctrl+F to Add Footnote

Detail of Nature: Ind->Indigenous purchased
Imp->Imported
Self->Self-manufactured or produced

Buttons: Print, Export to excel, Save, Close

(g) PART B-2 (b) UTILITY DETAILS

WEB-Cost-XBRL (Version 4.7) [Comp3] | Financial Year 2015-2016 - [Details of Utilities]

Financial Year : 2015-16
Level of Roundings : Millions

Unit of Measurement :
Name of Product / Service : -Select-

Particulars	Description	Nature	Unit	2015-16			2014-15		
				Quantity	Rate	Amount	Quantity	Rate	Amount
Utility 1									
Utility 2									
Utility 3									
Utility 4									
Utility 5									
Utility 6									
Utility 7									
Utility 8									
Utility 9									
Utility 10									
Total						0.00			0.00
Utility Consumed as per Abridged Cost Statement						0.00			0.00
Difference						0.00			0.00

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Print Export to excel Save Close

Taskbar: xbrl screen shots Syllabus 2016 WEB-Cost-XBRL Corrected - Paper... PART B-2 (a) MA... 12:22 04-10-2016

(h) PART B-2 (c) INDUSTRY SPECIFIC EXPENSES

WEB-Cost-XBRL (Version 4.7) [Comp3] | Financial Year 2015-2016 - [Industry Specific Details]

Financial Year : 2015-2016
Level of Roundings : Millions

Details of industry specific elements of operating expenses
Unit of Measurement :
Name of Product / Service : -Select-

Particulars	Description	Nature	2015-16	2014-15
			Amount	Amount
Industry specific expenses 1				
Industry specific expenses 2				
Industry specific expenses 3				
Industry specific expenses 4				
Industry specific expenses 5				
Industry specific expenses 6				
Industry specific expenses 7				
Industry specific expenses 8				
Industry specific expenses 9				
Industry specific expenses 10				
Total			0.00	0.00
Industry specific elements of operating expenses as per Abridged Cost Statement			0.00	0.00
Difference			0.00	0.00

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Print Export to excel Save Close

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(i) PART D-2 PROFIT RECONCILIATION STATEMENT

WEB-Cost-XBRL [Version 4.7] [Comp3] | Financial Year 2015-2016 - [Profit Reconciliation]

Master Audit Report Generate.xml Validation Tool Print CRA3 Video Utilities Help

Financial Year : 2015-16
Level of Roundings : Millions

Part D-2. Profit Reconciliation (for the Company as a whole) (Earlier Para-7)

Particulars	Specify	2015-16	2014-15
1. Profit or Loss as per Cost Accounting Records			
(a) For the audited product(s)/service(s)		387.39	-598.34
(b) For the un-audited product(s)/service(s)		0.00	0.00
2. Add: Incomes not considered in cost accounts:			
(a) Specify	Total of Incomes	148.63	819.34
(b) Specify	Interest on FD	59.94	72.10
(c) Specify	Amount written back	27.54	728.43
(d) Specify	Profit on sale of FA	0.00	0.00
(e) Specify	Sale of MS scrap	15.81	7.18
(f) Specify	Rent Income	45.18	0.17
(g) Specify	Receipt from Insurance Company	0.00	11.26
(h) Specify	Misc. Income	0.09	0.20
(i) Specify	Other	0.07	0.00
(j) Specify		0.00	0.00
(k) Specify		0.00	0.00
3. Less: Expenses not considered in cost accounts:			
(a) Specify	Total of Expenses	402.82	91.89
(b) Specify	Foreign Exchange Gain/Loss	52.05	18.93
(c) Specify	Exc. duty on closing stock	0.00	0.00
(d) Specify	Ind. tax paid on audit	3.59	1.92
(e) Specify	Sundry balance written off	0.00	-9.85
(f) Specify	Interest on statutory payments	91.28	57.71
(g) Specify	CSR Exp. and Donation	31.06	23.18
(h) Specify	Expences dring Shutdown Period	224.44	0.00
(i) Specify	Other Expences	0.40	0.00
(j) Specify		0.00	0.00
(k) Specify		0.00	0.00
4. Difference in Valuation of stock between financial accounts and cost accounts			
		-12.59	11.91
5. Other adjustments			
		-3.72	-99.61
6. Profit (loss) as per financial accounts			
		116.89	41.41

Note:- Use Expense/Income detail button if Data exceeds the specified lines

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Print Load Previous Year Data Income Detail Expense Detail Export to excel Save Close

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(j) PART D-3 VALUE ADDITION STATEMENT

WEB-Cost-XBRL [Version 4.7] [Comp3] | Financial Year 2015-2016 - [Value Addition and Distribution of Earnings]

Master Audit Report Generate.xml Validation Tool Print CRA3 Video Utilities Help

Financial Year : 2015-16
Level of Roundings : Millions

Part D-3. Value Addition and Distribution of Earnings (for the Company as a whole) (Earlier Para-8)

Particulars	2015-16	2014-15
Value Addition:		
1. Gross revenue from operations	5133.18	6193.51
2. Less:Excise Duty, etc.	284.60	629.47
3. Net revenue from operations of company for value addition	4848.58	5564.04
4. Add:Export incentives	0.00	1.55
5. Add/Less:Adjustments in work-in-progress and finished stocks	-219.47	-557.41
6. Less:Cost of bought out inputs		
(a) Cost of material consumed	1749.37	3614.88
(b) Cost of process material /chemicals	0.00	0.00
(c) Cost of Consumption of stores and spares	67.25	111.63
(d) Cost of utilities(e.g. power & fuel)	111.32	214.67
(e) Others,if any	1531.18	763.82
Total cost of bought out inputs	3459.12	4705.00
7. Value added	1169.99	303.18
8. Other incomes of company	164.25	830.91
9. Extraordinary income	0.00	0.00
10. Earnings available for distribution	1334.24	1134.09
Distribution of earnings to:		
1. Employees salaries wages retirement benefits	467.96	423.89
2. Dividend to shareholders	0.00	0.00
3. Company as Retained funds	85.34	10.18
4. Government as Taxes	31.55	31.25
5. Extraordinary expenses	0.00	0.00
6. Other Distributions of Earnings	749.39	668.77
Total distribution of earnings	1334.24	1134.09

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Print Load Previous Year Data Export to excel Save Close

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(m) PART D-6 RECONCILIATION OF INDIRECT TAXES

WEB-Cost-XBRL (Version 4.7) [Comp3] | Financial Year 2015-2016 - [Reconciliation of Indirect Taxes]

Master Audit Report Generate.xml Validation Tool Print CRA 3 Video Utilities Help

Financial Year : 2015-16
Level of Roundings : Millions

Part D-6. Reconciliation of Indirect Taxes (for the Company as a whole) (Earlier Para-11)

Particulars	Assessable Value	Excise Duty	Service Tax	Cess & Others	VAT
Duties/Taxes Payable					
Excise Duty					
Domestic	4764.61	266.45		0.00	
Export	0.00	0.00		0.00	
Stock Transfers (Net)	145.16	18.14		0.00	
Others, if any	0.00	0.00		0.00	
Total Excise Duty	4909.77	284.59		0.00	
Service Tax	45.18		6.33	0.04	
VAT, CST etc					190.25
Other State Taxes if any					23.30
Total Duties / Taxes Payable	4954.95	284.59	6.33	0.04	213.55
Duties/Taxes Paid					
Cenvat/VAT Credit Utilised - Inputs	0.00	59.72	0.00	0.00	12.00
Cenvat/VAT Credit Utilised - Capital Goods		20.92			0.00
Cenvat/VAT Credit Utilised - Input Services	0.00	49.42	0.00	0.00	
Cenvat/VAT Credit Utilised - Others		0.00			0.00
Total Cenvat/VAT		130.06	0.00	0.00	12.00
Indirect taxes paid through PLA/cash		129.94	4.28	0.00	187.76
Total Duties/Taxes Paid		260.00	4.28	0.00	199.76
Duties/Taxes Recovered		260.00	4.28	0.04	199.76
Difference between Duties/Taxes Paid and Recovered		0.00	0.00	-0.04	0.00
Interest/Penalty/Fines Paid		4.33	0.20	0.00	1.07

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Study Note - 7

MANAGEMENT REPORTING ISSUES UNDER COST AUDIT



This Study Note includes

- 7.1 Preface
- 7.2 Performance Analysis
- 7.3 Suggested Mechanism for Performance Analysis
- 7.4 Steps Approach Suggested for Report on Performance Analysis
- 7.5 Indicative Content of the Report on Performance Analysis
- 7.6 Capacity Utilisation Analysis
- 7.7 Productivity and Efficiency Analysis
- 7.8 Utilities and Energy Efficiency Analysis
- 7.9 Key Costs and Contribution Analysis
- 7.10 Product/Service Profitability Analysis
- 7.11 Market/Customer Profitability
- 7.12 Working Capital and Inventory Management Analysis
- 7.13 Manpower Analysis
- 7.14 Other Areas Suggested to be Covered in the Report on Performance Analysis
- 7.15 Management Accounting Tools

7.1. PREFACE

7.1.1 Performance measures help managers to create capable and matured processes. Measures are a tool to help understand, manage, and improve the performance of the organization as a whole. Effective performance measures can let us:

- Monitor performance to judge how well the company is fairing,
- Know if company management is meeting its goals.
- If appropriate actions have been taken to affect performance or improve efficiency if improvements are necessary.

There is no set number or formula to determine how many performance measures an organization should have. Tracking too many performance measures at once may cause managers to lose sight of which ones contribute directly to strategic objectives. On the other hand, having too few measures may not tell a good story about your work. The Report on Performance Analysis may be submitted to the Board of Directors of the Company, the performance measures which will be appraised should be discussed with the Company Management and then finalized for analysis and reporting thereof.

This guidance is not on strategic management in companies but using strategic management process in the context of performance analysis of companies. The guidance is a suggestive mode for performance analysis.

7.2 PERFORMANCE ANALYSIS

- 7.2.1 The basic objective to prepare a Report on Performance Analysis is to provide an actionable insight into costs and profitability for the management in the strategic and operational context. It aims at discovering various drivers of costs and profitability and their impact on the selected performance variables. It would help the organisations:
- to improve profits and profitability
 - to optimize resource allocation
 - to optimize the product and services portfolio
- 7.2.2 The objective is to provide assessment of the performance of the organisation across various spectrums. It inter-alia aims at satisfying the goals of management audit. It is concerned with providing the Board with information that it "should know" to take suitable actions to improve business performance.
- 7.2.3 The following criteria may help the management auditor to select and include the various performance measurement criteria in the Report on Performance Analysis:
- Effect on profitability
 - Effect on resource utilisation
 - Effect on liquidity
 - Effect on risks
 - Effect on quality
 - Effect on competitiveness
 - Effect on responsiveness to the market etc.
- 7.2.4 An ideal Report on Performance Analysis should possess the following characteristics:
- Objectivity
 - Capability of being predictive value
 - Comprehensiveness
 - No information overload
 - Coverage of strategic thrust
 - Trend measures and current status
 - Timeliness
 - Segmented and enterprise-wide coverage

7.3 SUGGESTED MECHANISM FOR PERFORMANCE ANALYSIS

- 7.3.1 After analyzing the activities within each process, we given below the suggested mechanism for performance analysis as follows:
- 7.3.2 In the above paragraphs, we discussed how the strategies are formulated, how they are implemented through the processes and now we come to assess the actual performance. Performance measures tell managers something important about the company's products, services, and the processes. Effective performance measures can let us:
- Monitor performance to judge how well the company is doing,
 - Know if company is meeting its own set goals and if the customers are satisfied,



- Take action to affect performance or improve efficiency if improvements are necessary.

So we need to identify appropriate Performance measures so that the analyst is provided data and information necessary to make informed decisions. Performance measures provide a snapshot of current performance capabilities and track whether actual performance is getting better, staying the same, or getting worse over time. Machine hour rate is a performance measure which provides us inputs for various decisions. Capital expenditures tell about the investment of funds; we communicate the return on that investment through performance measures.

7.3.3 Keep the focus of the chosen performance measure on things that matter most, such as:

- Are we accomplishing our mission to analyze the performance?
- Are the processes achieving strategic goals and objectives?
- Are the customers satisfied?
- Are various processes being managed by the company properly?
- Are the output and outcomes observed result in the company being cost-efficient as the industry leader?

7.3.4 The auditor could summarize the plan in order to have clarity. A suggestive format of the plan is given in the List- A

7.4 STEPS APPROACH SUGGESTED FOR REPORT ON PERFORMANCE ANALYSIS

Suggested below steps involved in the preparation of the Performance Analysis :

Preliminary discussion with the Management of the company to apprise them of the scope with specific reference to the company.

- 7.4.1 Identify and understand the key strategies of the company, both prescriptive and emergent strategies included.
- 7.4.2 Choose strategies that have more visible expressions in costs data maintained by the company.
- 7.4.3 Identify the activities that were impacted by the strategies selected and also implemented during the year.
- 7.4.4 Analyze the cost implications of those activities and link it with the expected results of the strategies.
- 7.4.5 Present the evaluation, in a table or any other easily comprehensible format like histogram, chart, graph etc.
- 7.4.6 Give explanatory notes for the terms used, calculations made, and assumption behind the evaluations.
- 7.4.7 Finalize the finding after a discussion with the concerned operating executives and then with the management of the company.

7.5 INDICATIVE CONTENTS OF THE REPORT ON PERFORMANCE ANALYSIS

7.5.1 The Report on Performance Analysis may covers the following indicative areas:

- (i) Capacity Utilization Analysis
- (ii) Productivity/Efficiency Analysis
- (iii) Utilities/Energy Efficiency Analysis
- (iv) Key-Costs & Contribution Analysis
- (v) Product/Service Profitability Analysis
- (vi) Market/Customer Profitability Analysis

- (vii) Working Capital & Inventory Management Analysis
- (viii) Manpower Analysis
- (ix) Impact of IFRS on the Cost Structure, Cash-Flows and Profitability
- (x) Application of Management Accounting Tools

7.5.2 For these and any other performance measures elected for inclusion in the Report on Performance Analysis, the auditor should also include wherever appropriate the following:

- Horizontal and vertical analysis of quantitative figures
- Trend analysis of performance parameters reflecting 3-10 years' figures
- Qualitative comments with interpretations of the cost auditor
- Comparison with external benchmarks such as industry average

7.6 CAPACITY UTILISATION ANALYSIS

7.6.1 The basic quantitative information on capacity is covered in the Annexure 1 of Part B and C of CRA 3 – Quantitative Information. However, this information is only indicative and does not provide analytical review. Capacity is usually expressed in terms of the final cost unit and where not so possible in terms of machine hours, people hours etc.

7.6.2 The concept of capacity is highly subjective. While on one hand it denotes the availability of resources, it would also mean the maximum rate at which the company can produce goods or services. Capacity does have considerable impact on the profitability. The auditor should assess this impact by analyzing and relating the impact of capacity costs on profitability.

7.6.3 The auditor should collect information of theoretical capacity, practical capacity, normal capacity and budgeted capacity for the period under review. Although the information may be available for all machinery & equipment, the auditor should identify the "constraint" that would limit the capacity of the entire organisation or product or a certain geographical area.

7.6.4 The auditor should assess various capacity limits for better analysis and reporting. All these have costs and could affect profitability. These are:

- Internal physical capacity – machinery & equipment
- External physical capacity – subcontracting and leasing
- The capacity of manpower bandwidth at all levels
- The financial capacity

7.6.5 When comparing the actual production with the capacity, the auditor should identify and analyze the reasons for variation due to controllable and uncontrollable causes. It would help to concentrate on material impact caused due to idle time, break-downs, lack of power, lack of material, lack of demand. It would be advisable to compute the cost impact of these.

7.6.6 Most of the capacity related information is available with the production and industrial engineering departments. The auditor should also refer to the CENVAT records for actual production data.

7.6.7 The auditor should comment on how the company responds to the variations in product demand by adjusting its capacity. This should be done with respect the cost impact.

7.6.8 The capacity performance measures could be:

- Capacity ratios to measure utilisation
- Identify bottlenecks & their impact on costs



- Ability to serve markets by creating short term capacity
- Analysis of throughput per hour of constraint capacity resource and return per hour at this resource (could be done decomposing the Throughput Accounting ratios)
- Committed capacity costs by process and managed capacity costs by process
- Impact of wastages on capacity utilisation

7.6.9 The auditor's checklist would include processing of information gathered from sources like:

- Technical documents pertaining to the equipment
- Production planning reports
- Interviews with managers responsible
- Wastage and down-time reports
- Benchmarking exercises done, if any
- External sources providing suggestive capacity reporting formats like CAM-I publications (Consortium for Advanced Manufacturing – International)

7.6.10 Suggested additional references

- Cost Accounting Standard (CAS- 2) – Capacity Determination issued by the Institute of Cost Accountants of India
- CAM-I capacity model developed by Consortium for Advanced Manufacturing – International, Texas
- Capacity Utilisation Bottleneck Efficiency System (CUBES) model
- SEMATECH's approach to Overall Equipment Effectiveness (OEE)
- Theory of constraints model (TOC)
- Balanced Score Card – by Robert Kaplan
- AA1000APS (Principles)
- AA1000AS (Assurance)
- AA1000SES (Stakeholder Engagement)

7.7 PRODUCTIVITY AND EFFICIENCY ANALYSIS

7.7.1 Productivity involves variables of input resources and the output. Measuring, identifying and isolating the different input resources and analyzing their contribution to produce goods and services and their effect on costs and profitability is imperative for improving business performance. It should be noted carefully that productivity is a measure of efficiency per unit of output, whereas efficiency is generally measured in totality.

7.7.2 The auditor could understand and analyse the whole chain of input-processing-output. This analysis, while traditional and very basic, would help auditor to comment upon the performance of the organisation across products or product groups. It is necessary for the auditor to understand the input ingredients for each product, product group, customer etc.

7.7.3 Annexure 3 & 4 of Part of CRA-3 to the cost audit report provide some basic information about the input costs and their relation with the output. The auditor should further analyse these areas to identify causes of good performance and areas that need improvements.

7.7.4 The considerations in measuring productivity and efficiency performance could be:

- Performance of input factors such as material, people, tools, equipment, processes, management, capital funds etc.

- The output factors could be units produced and sold, number of customers served, reduced costs, improved responsiveness etc.
- It's not just the productivity, but the improvement (or lack of it) in it that must be measured. This could be done by identifying whether the company is able to
 - ✓ Achieve more output with same input
 - ✓ Achieve same output with less input
 - ✓ Achieve much more output with relatively less increased input
 - ✓ Achieve slightly less output with much less input
- For each selected area, the auditor should identify whether the improvement is permanent or temporary and report on the same. The recommended approach for the organisation should be focusing on the sustainable improvements. Care should be taken to identify and report potential manipulations.
- Alongside the productivity or efficiency ratios, the cost auditor should also analyse and report on the effect of the same on quality. The auditor should isolate quality of various inputs and their effect of the output.
- The performance measures in respect of this area could be:
 - ✓ Inputs utilised (material, man, machine, capital etc) per unit of output or output obtained per unit of an input variable
 - ✓ Wastages as percentage of input
 - ✓ Indices could be developed for Single Factor Productivity (SFP), Multi-Factor Productivity (MFP), Total Factor Productivity (TFT)
 - ✓ Inter-relationships in various productivity measures e.g. output per man-hour may have increase, but if it is accompanied by higher wastage per man hour, then there is no real benefit

7.7.5 The cost auditors checklist would include, inter alia, the following:

- The Bill of Material (BOM) for each product
- The standard cost card, if any
- Internal reports on consumption, wastages per unit of input to capture actual data
- Production scheduling and plans to measure labour & machine time productivity
- External benchmarking such as industry norms, best practices data etc. used by the company or generated by auditor for analysis

7.7.6 Suggested additional references:

- Publications by the Indian Productivity Council
- Industry association reports like Indian Machine tool manufacturers, Society for Indian Automobile Manufacturers, etc. to get the data on Industry averages for benchmarking.

7.8 UTILITIES AND ENERGY EFFICIENCY ANALYSIS

7.8.1 This is an extended analysis of single factor productivity in respect of the utilities and energy inputs acquired and consumed by the company. The importance of conservation of non-renewable energy needs no emphasis.

7.8.2 The utilities are resources that are used in the process of conversion of material and other components into a finished product, but these resources do not form part of the physical unit of the product. In manufacturing industries, utilities and energy form a substantial part of the conversion cost.



- 7.8.3 The broad headings under which the utilities and energy performance could be categorized are Power, steam, electricity, compressed air, water, etc. These utilities are consumed in the production process or in environment protection initiatives. The use of utilities for administrative functions may be found in terms of lighting, cooling, ventilation, heating refrigeration etc. The auditor should evaluate the impact from cost angle as well as from the viewpoint of conservation of energy. It is essential to check if there are any statutory norms prescribed for the company.
- 7.8.4 The auditor should gather information on whether the company falls under the energy intensive industries as per the schedule attached to the Energy Conservation Act 2001. These industries include Aluminum, fertilizers, steel, cement, paper and pulp, sugar, textile, chemicals, petrochemicals, gas crackers, etc.
- 7.8.5 For external benchmarking, it may be useful to refer to the practices followed by companies which are accredited by the Bureau of Energy Efficiency formed under the Energy Conservation Act 2001.
- 7.8.6 The performance appraisal parameters for energy and utilities would include the consumption of fuel for generating energy and then the use of the energy thus produced per unit of final product. The performance parameters could include the following:
- Energy generated per unit of fuel consumed or fuel consumed per unit of energy generated. This could be applied for power, steam, electricity, water etc.
 - Measurement of improvement in power factor (denoting reduction in the KVA demand charges)
 - The cost of generating energy per unit and the cost of consuming the energy per unit of the finished product would be the critical part of the analysis.
 - Trend analysis of energy costs as percentage of total production costs is a good indicator of performance

7.9 KEY COSTS AND CONTRIBUTION ANALYSIS

- 7.9.1 The thrust here should not be only on computation of numbers or percentages for various product groups under consideration. The auditor should check the reasonableness of the contribution by benchmarking with the industry average wherever applicable.
- 7.9.2 Financial performance is the major element of the performance management. This analysis involves assessment of major items of cost, their relationship with the volume of production and impact on the profitability. Annexure 4 of Part D of CRA-3 of the cost audit report provides information (for each product group) on operating ratios for the current and previous years. These ratios are computed as proportion of individual cost elements to the cost of sales.
- 7.9.3 The auditor could provide analysis of the cost information by highlighting any significant variation therein during the reporting period. These variations are caused by non-recurring, onetime costs that may vitiate the ratios. Suggestions to avoid such variations may be provided in the report. This could be having long term rate contracts, supplier agreements, consumption controls etc.
- 7.9.4 The cost information should include comparison of actual cost performance with the standards or budgets as the case may be. If the company is using target costs, the auditor could identify the cost gap and recommend the ways to reduce the same. The report should provide a commentary on variance analysis. The process followed by the organisation for investigation and correction of variances should be commented upon.
- 7.9.5 In addition to these, it would be necessary to enlighten the company management with an in depth analysis of contribution earned by each product group. The contribution analysis may be given an absolute amount per unit of the finished product or in terms of percentage of sales i.e. the PV ratio. The auditor can add value by pointing out contribution earned per unit of the key constraint resource.
- 7.9.6 The contribution analysis should also be extended to include the break-even analysis and the margin of safety at the current volumes. It may be necessary for the auditor to scientifically split the costs into fixed

and variable elements. This split should be validated every year to find out structural changes if any. It will help to include inter-firm comparison for the same.

- 7.9.7 The auditor should report on evaluation of use of the contribution analysis data by the management for decisions like pricing, accepting or rejecting an order, make or buy etc.
- 7.9.8 The checklist for the auditor could include reference to
- Sales and production records
 - Reconciliation with CENVAT records
 - Price lists and discount structure policy
 - Product cost statements
 - Operational budgets

7.10 PRODUCT/SERVICE PROFITABILITY ANALYSIS

- 7.10.1 The unit product or service profits are driven by two major components viz. cost per unit and selling price per unit. The auditor should analyse if the business belongs to the sellers' market or buyers' market. This would facilitate the assessment of impact of changes in selling prices and changes in costs on the profitability or otherwise of the products or services. While the selling price is a single number, the cost is the sum total of different elements. The auditor must ensure that the basis use to allocate indirect costs is consistently adopted by the company.
- 7.10.2 In case of services, the unit of measurement is very important and hence carefully selected. Further, due to the diverse nature of services, it is essential to exercise care in analyzing the profitability thereof especially when the services provided are not standard. Many times, there is a combined contract for sale of product along with the service & maintenance contract. In such cases, the auditor should bifurcate the sales and costs for each portion and then compute and comment on their respective profitability.
- 7.10.3 Care should be taken in splitting the joint costs in case of joint products and by products. The method adopted for separation of costs should be checked to ensure correctness and consistency.
- 7.10.4 It would help to separately identify the costs of production, selling & marketing and handling customer services.
- 7.10.5 The auditor is expected to provide a thorough evaluation to bring out the products and/or services that are contributing more or less to the overall company performance. For convenience purpose, the products and/or services could be classified in groups with similar risk-return profiles. This classification may be different from the 'product groups' in the cost audit report annexures.
- 7.10.6 The analysis should separately appraise profitability of newly introduced products or services and also their proportion to the total profits of the organisation. The auditor should incorporate the profitability analysis of products discontinued during the period.
- 7.10.7 The term "profitability" should be taken with an extended meaning to include, apart from the concept of accounting profit, the ROI analysis as well. It would be useful to analyse profitability of products/services in domestic and export market. Care should be taken to isolate reasons for the changes in the profitability percentages. Similarly, if significant, profitability on sales to the related parties may be separately highlighted.
- 7.10.8 The report should specifically highlight the top five and the bottom five products. This will help the company to understand which products or services are contributing to the performance and which are ones that are non-performing. Based on this the suitable corrective actions may be suggested.
- 7.10.9 The checklist for the auditor could include reference to
- Sales and production records



- Reconciliation with CENVAT records
- Price lists and discount structure policy
- Product cost statements
- Operational budgets

7.11 MARKET / CUSTOMER PROFITABILITY

- 7.11.1 Certain industries focus on limited markets and customer types, while the others are broad based. The management may choose to understand its position in the different markets and different customers it serves.
- 7.11.2 The auditor should observe the segmentation method adopted by the company for analysing its profitability. The objective is to take suitable action for the segments that are not performing as per desired targets by introducing campaigns or to pull out of those segments that are no longer attractive.
- 7.11.3 The markets could be segmented on the basis of geographical locations such as domestic & international, zones or regions. They can also be segmented based on customers, e.g. OEMs, institutional, dealers, aftermarket, retail etc. These are normally termed as channels of distribution. Sales and supplies to Government, related parties could also be used for analysis.
- 7.11.4 The challenge in all the above named method of segmentation lies in the computation of costs for each of them. The auditor should carefully evaluate the allocation of costs to the different channels, especially marketing & campaigning costs.
- 7.11.5 While analysing the profitability, the amount of turnover should not be ignored. There could cases of improved profitability and dropping turnover levels for the different segments. The auditor should perform trend analysis to judge the performance in such cases and recommend suitable measures.
- 7.11.6 A life cycle approach would provide better insight into the market or customer profitability analysis. Hence, the auditor could analyse the costs of acquiring the market or customer, costs involved in servicing and maintaining them and also costs involved in evaluating the potential thereof through market research. Example of how to look at "Cost per unit" when there are multiple customers and orders vary from quantities to deliveries. A Customer places the PO for X quantity to be delivered in four batches. Another customer places PO for Y quantity which is higher than Customer X, but delivery in equal number every month, which incidentally falls short of the minimum batch size. Here customer X, eventhough the quantity is lesser than customer Y, is economical to produce the required quantity as it costs less per item compared to Y.
- 7.11.7 This aspect of the report should specifically highlight the top five and the bottom five markets and/or customer/customer categories. This will help the company to understand the most profitable markets and customers/customer categories and also the ones that are consuming resources but not yielding profits.
- 7.11.8 In addition to the study of profitability, the auditor could comment on the risks associated with the markets and customers. This risk could be "concentration risk", e.g. overdependence on a few customers or selling in one market only. The other risk may be related to defaults by customers. The analysis of bad debt history would help the analysis.
- 7.11.9 The checklist for evaluation of performance in this area could be based on the study of
- Market and customer-wise sales and cost reports
 - The marketing campaigns undertaken by the company
 - Date on new markets or new customers added during the year

7.12 WORKING CAPITAL AND INVENTORY MANAGEMENT ANALYSIS

- 7.12.1 This part of the report should point out the efficiencies in operations through management of different components of working capital. The auditor should identify all the elements of working capital for each product group and evaluate the adequacy or otherwise thereof.
- 7.12.2 In case of multi-unit operations, the working capital and inventory management is centralized, with sub limits fixed for each manufacturing locations. While the working capital assessment is done for the Company as a whole, the key factor which influences the working capital requirement of each unit have to be kept in mind and evaluated.
- 7.12.3 On the whole, the auditor should critically examine the working capital policy of the company. The total working capital could be analysed into permanent and fluctuating components. It is necessary to check whether the funding of these components is consistent with the period of requirement.
- 7.12.4 Working capital decision is handling of the conflict between liquidity and profitability. The auditor could provide an independent assessment of how it is being currently handled and how it can be improved.
- 7.12.5 The analysis of working capital can be done using the traditional measures of ratios like current ratio, quick ratio, turnover ratios, number of days in operating cycle etc. These ratios could be computed for each product group separately. Analysis of the operating cycle of the company would be immensely useful.
- 7.12.6 For manufacturing industries, inventory is the major portion of the current assets. The auditor should evaluate the inventory management policy which would include, inter alia, procurement policy, stocking policy, inventory valuation method, inventory records and physical verification procedures. Benchmarking of the policy pursued by the company with the industry averages will enhance the value of performance report.
- 7.12.7 It will be appropriate to analyse the inventory into its components such as raw material and stores, work in progress and finished goods. For each of these categories, system of inventory control should be evaluated using tools like ABC or VAT or FSND analysis, EOQ technique, JIT system etc. The auditor should comment upon the quality of inventory asset using the inventory aging reports.
- 7.12.8 Another important component of working capital is receivables. Analysis of receivables is important for internal perspective (working capital management) and external perspective (customer management) as well. The auditor should peruse through the policy of the company regarding credit evaluation of customers, setting up of credit terms and credit limits, discount policy, collection & delinquency procedures etc.
- 7.12.9 Trade credit from suppliers is the most crucial spontaneous source of working capital funding. The performance in respect of this could be critical for operational efficiencies and liquidity of the company. The auditor could analyse the supplier-wise performance in respect of on time supply, quality issues, pricing, etc.
- 7.12.10 Observations about other components of working capital and trends therein could be noteworthy. These components may be loans and advances, other receivables and payables etc. the criteria for analysis here should be to find whether excessive amount is blocked in these areas. Cash management can be included in the analysis.
- 7.12.11 It will be helpful to include the observations on cost of working capital funding. These costs may include the interest paid on cash credit and loans, cost of using factoring services, cost of collection efforts, costs involved in cash management, cost of inventory carrying etc. These costs may be explicit or implicit. Reasonable assumptions could be made for computing the implicit costs. The total cost of managing working capital as a percentage of total working capital invested may be a very useful performance indicator.
- 7.12.12 The auditor's checklist could include the reference to the following:
- Records related to inventory of RM, WIP and FG, stock discrepancy reports
 - Inventory aging reports, reports on treatment of non-moving items



- Reports on receivables – aging, timely collection, bad debt etc.
- Terms and conditions of working capital funds such as bank credit, loans etc.

7.13 MANPOWER ANALYSIS

- 7.13.1 The depth of analysis of manpower could depend upon the proportion of manpower cost to the total cost of product or service. The performance criteria for this area will mainly be related to the costs and efficiency or productivity. Again, benchmarking with the similar organisations would be helpful.
- 7.13.2 The costs may be categorized into the cost of recruitment, cost of maintaining the manpower and the cost of separations. Recruitments costs may include position advertisements, commission paid to recruitment agencies, participation in job fairs or campus recruitment etc. The maintenance costs may be the training & development costs, facilities provided over & above the monetary benefits etc. The separation costs would mostly be implicit costs. These costs as a percentage of the total salaries and wages would provide an insight into the quality of manpower management. These costs could be further broken up as per the hierarchies of people. The time taken to recruit important positions may affect the performance adversely.
- 7.13.3 The factor returns from the manpower is in terms of growth in production and productivity, enhancement of skills and knowledge of the organisation. The auditor should analyse the figures of manpower productivity, idle time, overtime worked, absenteeism etc. These factors could be compared with the respective outputs such as increased production, increased sales etc. The criteria such as sales per person achieved, production per man hour etc. will add value to the Report on Performance Analysis.
- 7.13.4 The Report on Performance Analysis may include comments and observations about the employee learning and growth opportunities and their linkage with the improvement in overall performance of the organisation.
- 7.13.5 The auditor's checklist for this content area may be:
- Details of number of recruitments done, number of people left, the labour turnover ratios
 - The data on idle time, absenteeism
 - Manpower productivity reports
 - Use of temporary or casual labour
 - Turnover at the higher level of management
 - Training and developmental programmes and the feedback thereon

7.14 OTHER AREAS SUGGESTED TO BE COVERED IN THE REPORT ON PERFORMANCE ANALYSIS

- 7.14.1 It should, be noted that these are very comprehensive and could cover most of the aspects of enterprise performance.
- 7.14.2 The auditor should make use of the non-financial measures of performance that signal the direction in which the future performance is being driven. The various non-financial measures are listed in the List-B.
- 7.14.3 The companies may track performance using parameters such as EVA and therefore the assessment will have to be done to meet the specific requirement.
- 7.14.4 The listed companies clearly bring out business specific factors that may affect their performance going forward. This is usually given in the "management discussion and analysis" in the annual reports. The auditor should benchmark these with companies in the same industry and provide observation thereon.

- 7.14.5 Risk Analysis: That may affect the future performance. The auditor should
- Identify the sources of various risks
 - Assess the potential downside or upside effect thereof
 - Comment whether the risks are worth taking or suggest the acceptable range
 - Recommend risk mitigation tools and techniques to be used
 - Evaluate the effect of the existing risk mitigation tools used by the company
- 7.14.6 Environment and Sustainability: To provide insight into how effectively the company is following policies on CSR, environment and sustainability.
- 7.14.7 Quality Performance: Could be assessed by relating the quality costs incurred versus the benefits achieved by reduction in customer complaints or increase in customer satisfaction index.
- 7.14.8 R & D Performance: The future performance of companies would depend upon their success of the R & D initiatives. The auditor could provide a useful lead in this respect by including analysis of the R & D costs.
- 7.14.9 Business Process Performance: The auditor could evaluate various processes followed by the company and incorporate valuable assessment in the Report on Performance Analysis. The processes could be evaluated on the criteria like speed, accuracy, empowerment, hurdles, facilitation etc.
- 7.14.10 Human Resource Accounting: This is an extended analysis of total human resource costs, both explicit and implicit, which are capitalised at an appropriate discount rate. The auditor could observe the value of human asset and link it to the returns. This is an upcoming performance measurement criterion.
- 7.14.11 Value Added Analysis: The value added is measured as an absolute value created by the business and the distribution thereof to the employees and other providers of capital. The growth in the value added over a period of time could be observed and commented upon.
- 7.14.12 Performance of Intangible Assets: The business may have internally developed intangible assets. In financial accounting these are generally not capitalised. The value created by the intangibles could be computed as excess returns earned by the company over the industry average. This excess is supposed to be earned due to the presence of intangible assets like brand.
- 7.14.13 Stakeholder Performance Analysis: The performance for shareholders could be denoted by EPS growth, the stock price performance, market capitalization, dividend growth, EVA etc. The lenders' parameters would be interest coverage and debt-service cover ratios. The suppliers would look for business growth, and on time payments. Customers expect on time delivery, proper pre and post sales service, and reasonable prices. These are performance metrics could be included in the Report on Performance Analysis.

7.15 MANAGEMENT ACCOUNTING TOOLS

- 7.15.1 The performance measurement involves collection of information, analysing the same by establishing the inter-relations between them, interpreting the results and then arriving at meaningful conclusion. The collection of information depends upon various sources of data and other reports for various systems used by the organisation.
- 7.15.2 The data input is generally made in the accounting system used by the company e.g. the ERP systems. Most of the ERP systems facilitate input and capturing of even the non-financial data which can be then processed to produce desired reports. There is a lot of information to be accessed from outside of the ERP system. The auditor should identify such sources within and outside of the organisation and use information drawn from the same.



7.15.3 The management accounting tools could be used to analyse the performance with different purposes. The auditor should verify the tools and techniques used by the company and comment on appropriateness and adequacy thereof. The auditor could recommend more appropriate management accounting tool.

7.15.4 The following table shows various management accounting tools that are used to serve different objectives:

Purpose	Management Accounting tool
Control	Budgetary control, standard costing, variance analysis
Cost computation	Full(absorption) Costing, Job, batch, process or contract costing Activity based costing, Time Driven ABC
Cost reduction	Total Quality management, Quality costing, Kaizen costing, Lean manufacturing, Value Analysis and Value Engineering, Six Sigma
Pricing and decision making	Target costing, Life cycle costing, Throughput accounting, Variable or marginal costing
Total performance management	Balanced Scorecard, Performance Prism, Performance pyramid, Business Objects, Business Intelligence

7.15.5 The auditor should be acquainted with the intricacies of these and such other tools and what it takes to successfully implement and use them. The success of Report on Performance Analysis would depend upon not how many performance measure are considered, but upon how they are evaluated and assessed with the help of various management accounting tools.

List - A

Planning for the Report on Performance Analysis

Key Performance Indicators (KPIs) are simply the variables, independent or interdependent, in respect of which the goals can be set and performance measured to assess whether it is in furtherance of the enterprise objectives. Hence, for evaluation of performance the selection of KPIs must be chosen correctly in tune with the objectives. The KPI measurement should not be a static computation, but always needs to be compared with a benchmark set. The KPIs could be:

- (a) **Quantitative** – these can be financial or non-financial
- (b) **Qualitative** – these are often lead indicators i.e. they influence future performance
- (c) **Actionable** – those which can be influenced by enterprise actions or controllable
- (d) **Trending** – those which need to be assessed over a period of time to observe whether they are improving or not

At the outset, based on the initial discussion with the management, a proper checklist may be drawn in the following format for planning the Report on Performance Analysis:

KPI (performance measure) Also indicate if strategic or operational	Type of KPI (whether quantitative or qualitative)	Functional areas affected by KPI	Persons/ departments responsible	Measurement criteria	Comparison with (budget, standard, external benchmark etc)

Depending upon merit of each case, the auditor could factor in other things such as source of the information, measurement frequency, time periods to be covered, etc. This will facilitate clarity of understanding and once the auditor gets the management's nod on these basic elements, the Report on Performance Analysis can certainly be a value adding proposition for the company.

Suggestive list of KPIs

Performance area	KPI	Measurement
Financial performance	Turnover	Segmental revenue to total revenue % Segmental turnover growth % Total turnover growth % Growth % in new product sales New product sales as % of total sales Customer-wise sales Top 5 customers, bottom 5 customers' sales
	Margins	Gross margin % on total sales Gross margin % on segmental sales Gross margin % on new products Customer-wise Gross margin %
	Costs	Element-wise cost % to total turnover and segmental turnover Cost composition – nature-wise, variability structure, functional split
	Returns	ROI on product groups ROI on geographical segments ROI on new products ROI on new markets ROCE Value added to total income Earnings per share (EPS) Dividend per share (DPS) Retention ratio Price-Earnings (PE) ratio Market price per share
	Balance sheet	Current ratio, quick ratio Asset turnover (current and fixed assets) Growth in assets Capital expenditure % to total assets Debt-equity ratio Debt to total capital employed
Productivity & Efficiency	Material	Material cost % to total cost Material wastage as % to total input Contribution per unit of material used
	Labour	Production per man hour Production per employee Employee cost % to sales Idle hours % to total available hours
	Machine	Production per machine hour Growth in machine capacity utilisation Machine downtime ratio Break-down hours



Performance area	KPI	Measurement
Manufacturing performance	Operating cycles	Material turnover WIP turnover Finished goods turnover
Customer performance	Complaints	% of customer complaints to total orders Response time to resolve a complaint Customer-wise number of complaints Number of complaints repeated
	Development	Business growth % over 3 years
	Risks	Payment defaults Delinquencies Payment delays
	Retention and satisfaction	Customer retained over 3 years Customer satisfaction index On time order execution % Correct documentation % Customer orders delivered in full % Average time spent on customer relation
	Overall	Order-to-cash cycle days
Supplier performance	Delivery	On time supplies Supply of full quantity
	Quality	% of rejections
	Cost	Price reductions agreed – cost effect Price escalations given – cost effect
	Overall	Supplier satisfaction index Accuracy of forecasts shared

List - C

Additional references for cost auditor

1. Annual reports of the companies for current year and past years
2. Guidance given by companies to stock markets
3. Written Policy documents of the company
4. Company web-sites
5. Web-sites of industry associations
7. Macro-economic data from RBI, Ministry of finance and commerce & industry etc.
7. Management accounting tools and techniques – reference books and hand books
8. Cost accounting standards issued by the ICAI
9. Generally accepted cost accounting principles (GACAP) published by ICAI
10. Stock market information on prices, market capitalisation, market returns
11. Minutes of board meeting to the extent relevant
12. Personal meetings with the CEO/MD of the organisation and members of the audit committee and the Board
13. The cost accounting policy of the company
14. The cost accounting system of the company – costing methods
15. The CENVAT and VAT records maintained by the company
16. The monthly MIS reports – concentrate only on exceptional reports

Study Note - 8

BASICS OF MANAGEMENT AUDIT



This Study Note includes

8.1 Meaning, Nature and Scope of Management Audit

8.2 Audit of Management Process and Functions

8.1 MEANING, NATURE AND SCOPE OF MANAGEMENT AUDIT

8.1.1 Introduction

An organisation is today ridden with a number of audits – financial audit, internal audit, social audit, cost audit, energy audit, management audit, etc. Audit generally means examination taken from the Latin term “Audire” (hear). Audit, therefore, means listening to some one and deriving from the hearing, the usefulness of the action. In the case of a corporate body, audit takes the shape of examination of specific field of working viz. financial activities, organizational activities, management activities, social activities, etc. Each activity has a specific objective and responsibility and the function of Audit is to check and ensure fulfillment of responsibility delegated to the activity.

Management Audit is the total examination of transaction of an organisation, or parts of it, and includes checks on the effectiveness of managers, their compliances with company on professional standard, the reliability of management functioning, the quality of performance of duties and recommendations for improvement. In this context, the distinction between administration and management should be recognized. Administration is concerned with the structure of the organisation and the mechanism of its operations, whereas management relates to the leadership and direction of the people, the way in which they are controlled to exercise their functions within the administrative frame work. The question of audit arises only because of the ownership of many companies is widely spread between a large number of shareholders, and the running of the organisation lies with people holding comparatively a small portion of the equity. This dichotomy of dispersed ownership and entrenched management necessitates and examination to be done of the Management function itself by an independent authority.

In this context management audit undertakes examination of the effectiveness of management in controlling the total activities of the organisation in the accomplishment of the organisation objectives. Since a number of audits is conducted in various area, audit responsibility lies in avoiding any over lapping and selecting such areas not covered by an audit already, e.g., if internal audit examines adherence to procedures, management audit should examine the effectiveness of such procedures.

Management audit deals with –

- (i) the objectives of an organisation;
- (ii) the policies and procedures in terms of the objective of the organisation; and
- (iii) adequate performance of an organisation in terms of objectives, policies, and procedures.

8.1.2 Definition and Objects of Management Audit

Management audit is the unique process appraising the performance of directors, managers or in the other words, appraising the performance of the management. A working director is included as a manager for purposes of management audit. It is normally presumed to be a non-routine investigation into a performance of a manager or group of managers. But in a number of organizations management audit is now a regular feature to examine and improve managerial effectiveness.

It attempts to look into all aspects of the management performance. Management audit does not concentrate on financial matters alone as in the case of financial audit. It looks into the efficiency and effectiveness of performance in an organisation.

However, there is no general agreement as to the precise meaning of the term "management audit". The term has been variously defined by different authorities as follows –

"Management audit may be defined as a comprehensive and constructive examination of an organisation structure of a company and its plans and objectives, its means of operation and its use of human and physical facilities.

- William P. Leonard

"Management audit may be more specifically defined as being an investigation of a business from the highest level downwards in order to ascertain whether sound management prevails throughout, thus facilitating the most effective relationship with outside world and the most efficient organisation and smooth running internally."

- Leslie Howard

"Management audit is performed with the objective of examining the efficiency of the information control system, management and management procedures towards the achievement of enterprise goals.

- Churchil and Cyert

H. Washbrook in the book "The Board and Management Audit" has defined "Management Audit" as –

"the total examination of an organisation or parts of it, and includes in it aspects of operations audit like checks on the effectiveness of managers, their compliance with company or professional standards, the reliability of management data, the quality of performances of duties and recommendations for improvement".

"Management audit is an objective and independent appraisal of the effectiveness of the managers and effectiveness of the corporate structure in the achievement of company objectives and policies. Its aim is to identify existing and potential management weaknesses within an organisation and to recommend ways to rectify these weaknesses".

- CIMA Terminology.

The above definitions lead to the following conclusions :

Management audit is the systematic and dispassionate examination, analysis and appraisal of management's overall performance. It is a form of appraisal of the total performance of the management by means of an objective and comprehensive examination of the organisation structure, its components such as department, its plans and policies, methods of process or operation and controls, and its use of physical facilities and human resources.

Thus management audit is concerned with evaluation and appraisal of the control system and information in the entire or in various segments of the organisation. Its scope has been widened to appraise in detail the systems and subsystems, procedures, job-description and assignment, authorization, accountability, quality of personnel, quality of information generation etc.

Management audit is carried out to –

1. appraise the management performance at all the levels;
2. spotlight the decision or activities, that are not in conformity with organizational objectives.
3. ascertain that objectives are properly understood at all levels;
4. ascertain that controls provided at different levels are adequate and effective in accomplishing management objectives or plans of operations;
5. evaluate plans which are projected to meet objectives.
6. review the company's organizational structure, i.e. assignment of duties and responsibilities and delegation of authority.



The main objectives of management audit can be summarized as follows:-

- (i) to ensure optimum utilization on all the resource employed, including money, materials, machines, men and methods;
- (ii) to highlight efficiencies in objectives, policies, procedures and planning;
- (iii) to suggest improvement in methods of operations;
- (iv) to highlight weak links in organizational structure and in internal control systems, and suggest necessary improvements;
- (v) to help management by providing health indicators and help prevent sickness or help cure in case of sickness; and
- (vi) to anticipate problems and suggest remedies to solve them in time.

8.1.3 Need for Management Audit

Since independence India has not achieved the desired economic development as planned. Regional and Social imbalances have been continued over the years, which needs to be corrected for overall growth.

In the industrial field there is an alarming growth of sickness of industries. Large amount of resources of banks and financial institutions are involved in the rehabilitation of sick industries. In the unorganized sector also sickness is reported. Large amount of loans are being written off by banks and financial institutions arising out of sickness and inability to recover the loans.

The performance of the public sector enterprises is also dismal in spite of state protection in respect of product monopoly, administered prices etc. Public sector also employs a large number of people. As per the report of BIFR a major cause for sickness is managerial weakness besides other causes like falling market demand, non-availability of raw materials, shortage of working capital, labour unrest etc.

The main cause of all these economic and social problems can be attributed to managerial ineffectiveness, which in turn causes other problems. It is therefore imminent that an appraisal of managerial effectiveness is undertaken to monitor and remedy the weaknesses wherever exist. This is the function of management audit.

Management audit is now becoming more popular everywhere. Almost all progressive organizations undertake voluntary management audit due to its benefits as under :-

- (i) It helps management in framing basic policies for the organisation and to define objectives.
- (ii) In pursuance of the objectives of the organizations, management audit helps in preparing a viable and achievable plan for the organisation.
- (iii) It helps in setting up an organizational framework to implement the plans.
- (iv) It assists in designing systems and procedures for smooth operation of the organisation.
- (v) It helps in designing and reviewing management information system (MIS) for decision making to help in coordination, motivation and control of the operations.
- (vi) It assists in analyzing SWOT (strengths, weaknesses, opportunities and threats) of the organisation and assists in marketing the organisation stronger.
- (vii) In a developing country like India, management audit through CAG, public accounts committee and parliamentary committee on public undertakings, has helped the Government in identifying improper or wasteful use of funds, checking extravagant organization practices and curbing ineffective use of physical resources.
- (viii) Indian financial Institutions, banks and Board for Industrial Finance and Reconstruction (BIFR) have found management audit (called concurrent audit) useful in monitoring sick industrial units and to help the units in their rehabilitation.
- (ix) The Railways of India have subjected their finances to open discussion by public to improve resource

mobilization, reduce cost of operations and conserve their scarce resources which are main objectives of management audit.

- (x) It can help in analyzing social-cost benefit analyses for public projects like dams, power houses, national highways etc.
- (xi) It is essential whenever a unit is planned to be taken-over or an amalgamation or merger with other unit is proposed.
- (xii) Growing number of professional managers, the continuing separation of ownership from management, the wider distribution of stockholders, increasing competition and sickness in industry will sooner or later make certified management audit compulsory just as financial audit has become statutory.

8.1.4 Scope and Usefulness of Management Audit

The scope of management audit is decided by each organisation on its own needs. It has no limitations. It generally extends over all the resources deployed and commercial activities of the organisation including Directors and their functions.

- Managers, supervisors and their functions.
- Organizational structure.
- Equipment and facilities, and their utilization
- Methods and systems.
- Security of information.
- Resources utilization – their adequacy and efficiency.
- Planning and control etc.

The scope of management audit extends over all the functions of an organisation viz. management, personnel, administration, material administration, marketing, finance, etc. wherever the effectiveness of management needs to be examined.

Accordingly, the scope of management audit may include –

- (i) The suitability, practicability and present compliance or otherwise of the organisation with its desired objectives and aims.
- (ii) The current image of the organisation among customers, general public within its own particular industrial or commercial field.
- (iii) Efficient utilization of resources of the organisation.
- (iv) The rate of return of investors' capital – whether poor, adequate or above average.
- (v) Relationship of the business with its own shareholders and investing public in general.
- (vi) Employee relation.
- (vii) The aims and effectiveness of management at its various levels such as top level, middle level, and operational level.
- (viii) Financial policies and control relating to production, sales and distribution and in other functions of the organization.

An organization is accountable not only to its internal owners like shareholders but also socially accountable to creditors, Government, tax payers and consumers. Management audit extends to examination of accountability between the management and others at large. Audit mechanism ensures this accountability. Since the right to exercise control lies entirely with different set of people away from the owners, the examination of accountability and ensuring shareholders' and other participants' welfare becomes important. This is based on "Agency Theory" put forward by Jensen and Meckling.



The implications of separation of ownership and control were first analysed in depth by Berie & Menes in their study of development of Corporate Business in the USA. They observed that economic power was becoming increasingly concentrated in small number of people in large corporations and that within the corporation itself the right to exercise control which in law was vested in the hands of dispersed absentee shareholders, was effectively being usurped by entrenched management. Berie & Menes do not however, envisage transfer of power per se but lay emphasis on the initial conflict between the objectives of shareholders and managers. In this process the certification by an independent auditor gains importance.

Accountability and appropriate means for enforcing it is the main criteria of audit, particularly management audit. The process of accountability includes following elements:

- (i) Description of the organisation and its participants.
- (ii) Identification of objectives and the provision of relevant information to those objectives.
- (iii) Ability of action on the part of the participants.

The value of auditing can be only judged by its ability to promote accountability of an organisation through their participants. The process of accountability is concerned with the needs of the participants of an organisation to determine the extent to which the behaviour of the organization conforms with their expectations. The monitoring mechanism should have sufficient variety to provide appropriate information to enable the participants to attempt the affect the behaviour of the organization.

8.1.5 Uses of Management Audit

- (1) Management audit is useful in synthesizing, accounting, economic and other data required by management in constructing basic policy framework.
- (2) Management audit assists in establishing, reviewing and improving the planning system.
- (3) Management audit makes substantial contribution to system of goal setting in the organization.
- (4) Management audit ensures that the management is getting the adequate information for correct decisions.
- (5) Management audit ensures that the management properly uses the information that it is getting.
- (6) Management audit aids in the design and maintenance of adequate authority structure.
- (7) It helps in the improvement information system to expedite flow of information among responsibility centres.
- (8) It substantially contributes for improvement of entire communication system.
- (9) It helps management in pinpointing key functions or operations in the profit-making process.
- (10) It helps management in establishing better criterion for measuring results.
- (11) It helps management to avoid wasteful, unnecessary and extravagant use of resources.

8.1.6 Coverage of Management Audit

Unlike statutory audits, management audit does not have any specific area for conducting audit. It covers the entire arena of management operations including organisation, personnel, administration, manufacturing, marketing, finance, research and development and other areas. The audit is expected to cover every activity of the organisation undertaken in pursuance of organizational objectives or policies decided by the Board of Directors from time to time. It is left to the creativity of the auditor to lay down for himself the areas to be taken up for audit. In the result, management audit covers examination of efficient performance of the activities of the organisation.

8.2 AUDIT OF MANAGEMENT PROCESS AND FUNCTIONS

8.2.1 Concept of Management Audit

The concept of management audit was developed by T.G. Rose as a logical system of evaluating the quality of management. He employed it for evaluation 52 publicly owned companies over a period from 1948 to 1960. The demand for information on performance had become necessary subsequent to the oil crisis of 1973 to evaluate the performance of the management and to take consequent decisions.

Conceptually management audit covers areas which are not normally covered by other audits. Secondly, management audit does not go into the vouchers or other similar evidence but comprises of the appraisal of management effectiveness in various areas of managerial operations.

Management function include –

- (i) Planning.
- (ii) Organising.
- (iii) Staffing.
- (iv) Coordinating.
- (v) Communicating.
- (vi) Directing.
- (vii) Motivating.
- (viii) Controlling.
- (ix) Communicating.
- (x) Directing.
- (xi) Motivating.
- (xii) Controlling.
- (xiii) Innovating.

As such management audit covers the above functions of management in various areas of operations as detailed in the Table below :-

	Function of an organization	Marketing	Manufacturing	Materials management	Human resource management	Finance	R&D	Others
Management Process								
Planning								
Organizing								
Staffing								
Coordination								
Communication								
Direction								
Control								
Innovation								

Management audit should not be confused with organizational audit or administrative audit, which may form part of management audit. Management audit by concept goes into the details of managerial effectiveness in conducting the operations of an organisation.



Functions: The functions of management audit extend to audit of the effective functioning of every area of operations coming under the management purview from the stage of its planning to proper implementation and execution. Every manufacturing or service organisation could broadly be identified into the following functional areas –

- (ii) Marketing, including selling and distribution.
- (iii) Manufacturing/servicing, including maintenance of supply chain, machinery and equipment, etc.
- (iv) Human resource management from selection to recruitment, training, motivating, retaining, advancement, etc.
- (v) Personnel policies and industrial relations.
- (vi) Finance including maintenance of accounts and providing accounting information to guide the management of its performance and position.
- (vii) Research & development including application research and basic research, if any.

An understanding of the objectives of each functional area at every level of the organisation and effectively achieving such objectives shall be the prime responsibility of management. Checking of such effective achievement is the function of management audit. These are dealt with in more detail in subsequent sections.

8.2.2 Features of Different Types of Audits

The Table below brings out succinctly the distinguishing features of different types of audit carried out in an organisation :-

Ingredients	Management Audit	Internal Audit	Financial, cost and other audits
(i) Expectations	Appraising management	Assisting Management to identify problems	Specific under statutory and other's directions
(ii) Attitude	Friend, Philosopher and guide	Policeman/judge	Watch dog/judge
(iii) Agency	Outside team or management	Internal or External	Specially designated persons
(iv) Force	Voluntary	Statutory in some cases	Statutory/Voluntary
(v) Area	Complete Management or specific problems	Mainly past/ procedural	Specific objectives
(vi) Evaluation	Effectiveness/ quality of management/Policies	Quality of procedures Operations/data	Specific information
(vii) Period covered	Past, present and future	Past and present	Mainly past
(viii) Procedures	Flexible	Structured	Highly structured
(ix) Reporting level	Higher	Operational	Designated
(x) Time span	Futuristic	Current and immediate	Current and immediate past
(xi) Periodicity	Regular	Regular	Annual

Financial audit is statutory requirement for most of the businesses or public organisations/institutions. Tax audit under the Income-tax Act can also be covered under this category. It is an exploratory critical review by an approved independent agency and a monitoring mechanism to determine the extent to which the behaviour of the organisation conforms to the expectations within a definite frame work. It leads to an opinion on the correctness of the presented data and information. It also ensures adherence to generally accepted accounting principles applied on a consistent basis. However, financial audit has a major shortcoming. It is only a postmortem. It is procedural and rule oriented. It can not be used as a management tool due to its annual reporting. The information therein comes too late, is too much in aggregate and is too little for managerial decision.

Cost audit is also a legal reporting exercise, connected with annual reporting to the government regarding efficiency of operations with particular reference to a specified product in a prescribed format. It restricts the freedom of the auditor to report, being confined to specific areas only. The report does not reach the investors i.e. shareholders. It does not examine and analyse the role of top management in leading and decision making. However, cost audit deals with many strategic functions of an organisation and can be developed into management audit by interaction of cost auditor with Board of Directors and by widening its scope.

Internal audit is useful in ensuring a reliable accounting system. It helps internal monitoring of the effectiveness of control procedures. It helps in generation of reliable financial information depending on the reliability of accounting system itself. This is an indirect help to financial auditors as it reduces their work. Internal audit is compulsory for companies above a prescribed size under Companies (Auditors' Report) Order, 2015 under the Companies Act, 2013 in India. Gradually, the scope of internal audit in Indian Companies has been enlarged from merely clerical activity to a management tool of great use. It is carried out by own employees at middle level in large and medium companies who cannot report fearlessly. It is mainly confined to verification or compliance of set procedures. It does not cover top management appraisal or responsibility accounting.

Operational audit concentrates on seeking out aspects of operations in which waste, inefficiency and excessive costs would be subject to reduction by the introduction of improvement of operating controls. It is audit of the performance at mainly operating level i.e. supervisory level. It is also termed as micro level management audit.

Management audit extends to the entire management decision making areas and has a broader time frame to analyse past, present and the future. Hence it becomes a qualitative audit and not audit of only value and quantity. Management audit brings out errors or policy, decisions, and actions with recommendations to avoid them. Management audit extends beyond operations audit.

8.2.3 Management Audit – Techniques and Procedures

(1) Steps of management audit :

The steps of management audit are :-

1. Select an area of operation of management
2. Establish what should be the objective, standard or target of the operation.
3. Determine whether the actual results meet the standards, norms or targets. If not, why not?
 - (i) Is the target too difficult?
 - (ii) Is failure to achieve the target costing the organisation?
4. Establish what is done to ensure the achievement of the norms, target and standards.
What steps are taken for –
 - (i) planning
 - (ii) operations, execution and implementation e.g. use of up-to-date technology.
 - (iii) Measurement of performance and controls?
5. Carryout a detailed investigation, collect evidence as well as document for audit findings
6. Report the findings of the audit and make recommendations.

(2) Management auditing procedure:

Audit procedures should be tailored to the specific needs of each situation examined. The general approach in a management audit may be outlined as follows :-

1. Make a preliminary survey of the activity under audit to obtain necessary background and other working information for use in conducting the audit.
2. Study the basic charter or assignment of responsibility of the activity under audit (applicable laws and related legislative history in the case of a government activity) to ascertain the authorized purposes and related authorities of the activity and any applicable restrictions or limitations.
3. Review pertinent parts of the system of management control by studying the policies established to govern the activities under audit, testing the effectiveness of specific operating and administrative procedures and practices followed, and fully exploring all significant weaknesses encountered.
4. Report on the findings of the audit work performed to those responsible for receiving or acting them together with the recommendations for improvement.



Techniques by which the auditor can identify problems areas warranting detailed examination and source of his information are as follows:

(i) Identification of possible control weakness by survey

During the preliminary survey work though which practical working information is obtained on how the activity is supposed to function and on how the activity is supposed to function and on how control procedures are supposed to work, key features or aspects can usually be identified which appear to be difficult to control effectively or to be susceptible to abuse. In a purchasing organisation, for example, the key points in the purchasing process may be –

- a. the determination made of the quantities and the quality of materials to be purchased.
- b. The procedure followed in obtaining the best prices, and
- c. The methods for determining whether the correct quantities and quality are actually received.

If, in relation to the total purchasing operation, the auditor concludes that these processes are the most critical from the standpoint of the need for good performance, he would be justified in concentrating his testing work on them.

(ii) Review of management reports

The auditor's review of internal reports which the management itself regularly uses to obtain information on progress, status, or accomplishment of work can be valuable sources of information on possible problem areas suggesting audit attention.

(iii) Review of internal audit or inspection reports.

These report can also be a valuable source of information on problem areas. Of particular interest to the management auditor are those reports which bring to light significant findings on which the management has taken no action. Inquiry into the reasons and justification for inaction in such cases should be made, since these circumstances could throw light on weaknesses in management system that have not previously been referred to the management for resolution.

(iv) Physical inspection

Physical inspections of the organisation's activities and resources can be a useful way of identifying possible inefficiencies. Examples are apparently excess accumulations of material, idle or little used equipments, employee idleness, rejections of product by inspectors (or customers), executive rework operations, or disposal of apparently useful materials or equipment.

(v) Test examination of transactions

A very useful way to obtain a practical insight into the efficacy of procedures is to pursue a number of transactions pertaining to the organisation's operations from initiation to final disposition. This kind of testing will provide the auditor with valuable information on the organisation's business is actually transacted, on the usefulness (or pertinence) of prescribed procedure, on the capabilities of personnel involved in the various operating phases, and on possible weaknesses in procedures or practices which could represent an unnecessary drain on the organisation's resources (i.e. ineffective or inefficient performance)

(vi) Discussions with the officials and employees

The management auditor can obtain valuable information on problem areas warranting audit attention through discussions with responsible officials in the organisation and other employees concerned. The degree of success in obtaining useful information in this way is, in large part, dependent on the auditor's reputation for independent and constructive inquiry. If he is regarded with fear because of overly critical reporting in the past, this source of information may not be productive.

Testing procedures and practices

Testing procedures and practices first requires some preliminary review work to obtain information on how they actually work and an insight into their effectiveness and usefulness. On the basis of such review, specific matters may be identified as problem areas on weaknesses needing further probing. The general factors to be considered by the auditor in his preliminary review work on management controls are :

- Whether the policies of the organization comply with its basic charter or grant of authority.

- Whether the system of procedures and management controls is designed to carry out those policies and result in activities being conducted as desired by the top management, and in an efficient and economical manner.
- Whether the system of management controls provides adequate control over the organisation's resources, revenues, costs and expenditures.

Specific factors which may well be considered by the auditor in assessing the management control system and identifying problem area warranting more detailed audit include –

The use by management of standards or goals in judging accomplishment, productivity, efficiency in the use of goods or services.

Lack of clarity in written procedures, misunderstandings or inconsistent interpretations in the organisation may affect :-

- capabilities of personnel
- failures to accept responsibilities
- duplication of effort
- improper or imprudent use of funds
- cumbersome or extravagant organisational patterns
- ineffective or useful use of employees and physical resources.

This listing is indicative of the kinds of factors that an alert management auditor must keep in mind in all his work. The knowledge gained in preliminary review that is conducted in recognition of these kinds of factors provides a solid basis for more detailed examination work that can lead to constructive improvements in the management system.

(3) Techniques of management audit :

Techniques employed by a management auditor in effectively carrying out his audit are –

(i) Accounting or economic techniques

- (a) Break-even analysis
- (b) Budgetary control including flexible budget system
- (c) Cost management techniques indicating how an organisation's assets should be allocated over competing projects or to decide whether it is worth proceeding with the investment, keeping in view proportionate value of expenditure on such projects.
- (d) Discounted cash flow and net present value methods.
- (e) Cost benefit analysis.
- (f) Standard costing and marginal costing
- (g) Activity based costing to test the relevance of costs to activities.
- (h) Quality analysis of company transactions.

(ii) Scientific techniques

- (a) *Computer Models* : There are many types of problems which can be solved on a computer e.g. decision on material mix, product, mix, make or buy etc.
- (b) *Network analysis* : To analyse strings of tasks to arrange them in sequential or parallel order to complete the project in shortest possible time.
- (c) *Mathematical programming* solving by heuristic (trial and error) techniques to determine the best material mix, best use of organisation's transport fleet, the best mix of products to obtain, to maximize profits and optimum use of labour, finance, equipments, etc. Linear programming is usually effective when relationship vary in linear order whereas quadratic programming may be used when the variations are in the order of square root of some other factors.

(iii) Statistical techniques

- (a) *Activity sampling* : It is one of the many ways in which the present workloads can be measured to obtain controls to be exercised by management.
- (b) *Monte Carlo Simulation* : In this a number of variables are drawn from large statistical population which have equal choice of being selected and obtain the best sample possible.



- (c) Exponential smoothing
- (d) Interfirm comparison
- (iv) **Personnel techniques**
 - (a) Attitude survey
 - (b) Ergonomic (Man-machine relationship)
 - (c) Training methods
 - (d) Profitability and productivity measurement
- (v) **General techniques**
 - (a) *Statistical theory of management* is an attempt to emphasize what should be the practical approach to a problem by –
 - Analyzing the problem to establish the basic difficulties and factors involved.
 - Establish management by objectives.
 - Identifying the likely ways of tackling the problems in the light of objectives to develop a solution.
 - Determine the key factors affecting management decision-making.
 - Evaluating alternative courses of action
 - Evaluating each alternative in terms of economy, efficiency and best fit.
 - Specifying the action required to exploit the situation to the best advantage of the organisation.
 - (b) Brain storming
 - (c) Transfer pricing
 - (d) Management by objectives
 - (e) Management by exception
 - (f) Corporate planning
 - (g) Information theory

(4) **Management Audit Evidence :**

Unlike financial audit or other audits there can be no fixed items of evidence to be checked by a management auditor. A management auditor has to rely more on his experience and acumen to identify areas of review and study, particularly areas of weaknesses to be overcome, strengths to be exploited and risk to be properly covered.

The auditor's evidence comes from his discussions with the people concerned in the organisation, the survey and review of various reports of the organisation, including internal audit reports, inspection reports or any investigation reports, physical inspection, test examination of various transactions, inspection of important departmental files, monthly performance review statements, minutes and notes and above all personal observations.

Evidence can be gathered either by sampling techniques or by going into full details depending upon what the samples reveal. The evidence should be such that an auditor can draw valid conclusions, duly verifying the same with the people concerned. It should be understood that a management auditor does not rely on a voucher as an evidence, but shall fall back on various records, including vouchers as evidence for his audit, if the samples demand so. There is no area of restrictions for obtaining evidence.

(5) **Management Audit Programme (MAP) :**

Management audit programme is an essential prerequisite to conducting the audit. It is a plan of action drawn in advance of taking up the audit, and to help the auditor to cover the entire area of his function thoroughly.

He should lay down for himself a proper procedure to be followed to complete the work in time, giving thorough coverage to all aspects.

An efficient management audit programme shall comprise the following:

- (i) Review of the organisational objectives and plans
- (ii) Study of the policies and practices of the management

- (iii) A critical review of the organizational structure
- (iv) Study of the systems and procedures
- (v) Evaluation of operations
- (vi) Study of the efficiency of the use of physical resources available
- (vii) Exercise of proper management control
- (viii) Maintain suitable monitoring system through management information system (MIS)
- (ix) Check on adherence to the statutory obligation and
- (x) Above all, review the efficiency of manpower handling, which ultimately results in the organisation's success.

An audit programme is laying down the path in its required details before conducting such audit.

A management auditor shall shrewdly assess weak and risk areas in the organisation and deal with such areas in more detail. He has to lay down a programme by making a list of such weak and risk areas and follow them up in his audit.

(6) Management Auditor

A management auditor is expected to offer special skill and expertise to his clients. He, therefore, has a special responsibility to exercise special care in the performance of his duties to ensure positive response to his opinion to motivate action thereon.

A management auditor should be competent in the exercise of his audit function and formulation of his opinion based on such audit. He should be a man of independent thinking, who can maintain an unbiased view, without any influence, either financial, sentimental or otherwise. He should be technically competent in the discharge of his duties, having had education, training and experience all round. The management auditor should be supported by a good organisation i.e. a team of people who can competently execute his audit.

Qualifications of Management and Administrative Auditors.

Prime qualification of a management auditor is to possess broad business experience in allied profession such as accountancy, statistics, engineering, marketing or administration. It is not possible that one person can possess all the specialized qualifications. But a special qualification in one field could have a respective view of the whole system. If a team of auditors is appointed it will be preferable to have people from different streams, because a cross fertilisation of ideas from different business fields can be a stimulating factor. Management audit should aim at highlighting any team of administration or managerial efficiency or otherwise affecting the performance of the organisation.

The essential qualities of a management auditor are :-

- (i) Ability to grasp the business problems
- (ii) General understanding of the nature, purposes and objects of the organisation e.g. nationalized or government controlled organisation etc.
- (iii) Ability to determine or assist the progress of the organisation
- (iv) Knowledge of the principles of delegation of authority and control and the preparation of different budgets viz. cash budget, production budget, master budget, etc
- (v) Power of grasping and understanding different internal control devices viz., flow chart, flow of work, analysis of work scheduling, use of computer, etc.
- (vi) Sufficient knowledge about engineering statistical techniques, cost and management accounting, general financial accounting, production planning and control etc.
- (vii) General understanding of different laws viz. company laws, tax laws, FEMA, MRTP, and other economic legislations.
- (viii) Sufficient knowledge and experience in preparing various reports for submission to different levels of management including the top management
- (ix) Tactfulness, perseverance, pleasing and dynamic personality.

(7) Management Audit Team – Organisation

A management auditor handling a large organisation on a continuous basis or a number of audits at the same



time has to build up a competent team of people, who possess the qualifications attributed to a management auditor.

As a management auditor is concerned with all aspects of the business and the organisation, ranging from manufacture, to marketing and finance, the management audit team should be multi-disciplinary to make multidimensional approach to audit function.

A competent management audit team, internal to an organisation, could effectively be represented by the heads of various departments viz., production, materials management, maintenance, personnel, marketing, finance, industrial engineering, quality control, etc. Such a team can competently lead and direct the audit to attain the organisational objectives.

(8) Audit Checklist :

A management auditor shall normally maintain an audit checklist to ensure that he has not omitted any areas that require to be audited. The organisational areas covered fall under the broad categories of :-

- Planning
- Organising
- Staffing
- Coordinating
- Communicating
- Directing
- Motivating
- Controlling and
- Innovating

In these areas an auditor should look for any weakness which may affect efficiency of the organisation. His checklist can be made area wise and may be overlapping or complementary between different areas.

- (i) Directorial weakness
- (ii) Management weakness
- (iii) Organisational weakness
- (iv) Financial weakness
- (v) Systems weakness
- (vi) Procedural weakness
- (vii) Functional weakness
- (viii) Operational weakness
- (ix) Marketing weakness
- (x) Industrial relations weakness
- (xi) Weakness in meeting social responsibilities, and
- (xii) Security lapses etc.

A model list of audit checklist under various categories is attached in the Appendix hereto.

8.2.4 Management Audit Report (MAR)

It is of important to prepare a good MAR. A good MAR can motivate the management and get the required results.

Characteristics of a good management audit report

The detailed characteristics of a good management audit report can be summarized as follows :

- (i) Pertinence
- (ii) Comprehensiveness
- (iii) Brevity
- (iv) Timeliness
- (v) Motivating
- (vi) Formatting

Contents of the report.

The top policy executive is generally interested in four factors in operating statements – facts, person responsible, deviations in actual performance from standards and the effect of the result on financial or physical status of the organisation.

The report must allow management to study comparisons, to review organisation, and to appraise the effectiveness of the executives. Departmental weakness can be quickly seen by the management, if the report is properly prepared.

Management audit report should create awareness among the management of prudent management practices that can make organisation come alive. It is very important function of management audit to help change of management mind-set.

A management audit report should also be discussed with the people concerned in various areas before reporting. Every point that is raised in the report should have the acceptance of the people involved in the concerned function. A report that indicates suggestions that had come from the people themselves would have a better than coming as a suggestion from auditor.

The report should be drafted and structured so that it makes a logical presentation to the management and makes it easily readable. The report should contain not only the problems and defects in the working but also should come out with solutions as if given by the operational people themselves so that it gains immediate acceptance for implementation. A management audit report relies heavily on accepted managerial practices and feasible solutions.

Special Reports for Banks, Shareholders, Employees & Small Business

Sometimes, the reports have to be prepared and submitted for special persons or purposes. Salient features for these special reports are briefly discussed below:-

(1) Reports for banks and creditors.

Form and content of financial statements and schedules are important to the lender but explanatory notes to the statements and schedules are perhaps more important to them. They require accuracy in report and confirmation of statement made, which should be properly verified and certified. Bankers are more oriented towards security due to their long-term expectation of debt servicing by the business. Hence, reliability of report is an important factor. All statements by the auditor should be clear and positive.

(2) Report to shareholders

The report are read by financial experts, bankers, tax authorities, public officials and research people. The report should, therefore, be useful in analytical details for its user, and give full facts of the organisation's business. The report should also convey the right and correct message to a lay man. The reports is often used as a public relation exercise to improve relations with investors and to promote loyalty. In India, auditor's report in the prospectus at the time of public issue is very important. Experts read "between the lines" of the auditor's report. It will ultimately reflect in the auditor.

(3) Reports to employees

Reports for employees are mainly prepared for better understanding of the business, to dispel any misconceptions, counter charges by unions, or explain the need for continuance of the business in times of strike, competitions or sickness. The report to employees must gain the confidence of employees and earn respect for the statements. The report should consider the needs of employees, when the employee morale is low or where the relations with employees are strained. Auditor's views will be expected to be totally unbiased.

(4) Reports for small business

The form of annual accounts and other requirements under the Companies Act is the same for a large or a tiny private company. However, the management auditor should design his report in a very simple way as the report for a small business is specifically directed to a person or a small group of persons only. A great deal of reporting for small business is subjective, due to lack of adequate data. This poses problems in analyzing and comparing data. Suggestions in the report must be based on proper appraisal of the problem.

Conclusion : The report of the management auditor will leave a permanent impact on the user about his competence, integrity and honesty. He should, therefore, make his observations and recommendations clear even if it may affect the job of any executives or affect the fortunes of a few people concerned for interested for the organisation. He cannot escape the duty to judge the right and the wrong. The best report is one which motivates the person receiving the report to act in the manner desired in the report.

Study Note - 9

MANAGEMENT AUDIT IN DIFFERENT FUNCTIONS



This Study Note includes

- 9.1 Corporate Objectives and Culture
- 9.2 Corporate Services Audit
- 9.3 Corporate Development Audit
- 9.4 Evaluation of Personnel Development
- 9.5 Consumer Services Audit
- 9.6 Audit of Social Responsibility of Management – Environmental of Pollution Control
- 9.7 Audit Checks of Different Functions
- 9.8 Corporate Divisions/DEP Apartments/Functions
- 9.9 Energy Audit
- 9.10 Productivity Audit/Efficiency Audit**
- 9.11 Propriety Audit
- 9.12 Corporate Social Responsibility (CSR) Audit

9.1 CORPORATE OBJECTIVES AND CULTURE

Corporate Objectives

Corporate Objectives are the overall objectives of the organization that influence the direction of corporate strategy. In other words, what the organization seeks to achieve is corporate objective. These are the specific, realistic and measurable aims which an organisation plans to achieve. These represent the charter that the organisation has laid down for itself. These corporate objectives could either be written or unwritten. Many experts feel it would be better to have a written charter for any body in the organization or outside to know what the organization stands for and to be understood and followed, rather than known by trial and error. Moreover, all good plans must support the overall corporate objectives of the organisation. For example, the corporate objectives of a company could be to become global leader in the next five years. This means that all individual plans must support the achievement of this objective. Similarly, the corporate objectives of world famous 'NIKE' company are reproduced as under:

- Protect & improve Nike's position as the number one athletic brand in America;
- Build a strong momentum in growing fitness market;
- Intensify the company's effort to develop products that women need and want;
- Explore the market for products specifically designed for the requirements of maturing Americans;
- Direct & manage the company's international business as it continues to develop;
- Continue the drive for increased margins through proper inventory management and fewer, better products.

The corporate objectives of 'General Electric Company', USA are :

"To become the most competitive enterprise in the world by being number one or number two in market share in every business the company is in."

The corporate objectives of 'Apple Computers, USA are :

"To offer the best possible personal computing technology, and to put that technology in the hands of as many people as possible."

Many companies do not have a clear understanding of their business objectives. Some of these companies go for acquiring of unrelated businesses just because others are also doing in the hope of being equally successful despite the fact that they don't know much of that business or industry. Similarly many companies do not successfully make their employees aware of its corporate objective or how they are very important part of it. Therefore, it is very important that corporate objectives are defined in concrete and understandable terms. These corporate objectives need to be defined in broad terms that allow some degree of flexibility, but should not be defined in terms that make the objective nonexistent. For example, a company making games can have any of the followings as their corporate objectives: (a) making children's games; (b) making games; or (c) providing entertainment. The set of assumptions and strategies that go with each objective are totally different and the business operations will differ dramatically depending upon the exact choice of corporate objective. Similarly, a company planning to consolidate its marketing share in the country (national market) might have totally different objectives for market as compared to another company seeking to become global leader because the needs of customers may be totally different in each of the country.

Corporate Culture - Concept

"Culture is to know best that has been said and thought in the world" – Mathew Arnold.

Culture refers to a corporate's values, beliefs and behaviours on the basis of which people interpret experiences and behave. Generally firms with strong cultures achieve higher results. In simple language, corporate culture is the operating working environment and is shaped by the way people conduct their work, the way customers are treated and served, the way workers interact with each other or their supervisors or the way people present themselves.

Corporate culture unites the enterprise as a family and develops closeness of feeling among all. Like a family culture, customs and traditions Successful companies often boast about "our accomplishments" and "my failures", whereas unsuccessful companies generally have as the three R's in their corporate culture i.e., "resistance", "resentment" and "revenge" and these three 'R' send an organization on its way to "tiredness". Thus, the corporate culture is always visible in workers attitudes, work ethics and impacts heavily upon workers ability to make decisions and respond to customer needs, workers satisfaction and ultimately the bottom line. It must be understood that the corporate culture is always independent of corporate policies and usually comes from the corporation's leaders, even though it belongs to all employees collectively.

An example, which is often given, is that some of the companies continue to introduce market innovations, dominate markets and are highly profitable, while other companies in the same business continue to struggle with success eluding them. Since all the companies are in the same business, one can easily rule out the external factors like market conditions. This leaves one with the conclusion that the lack of success is caused directly by the company and the type of environment or culture it has for taking decisions.

In this era of globalization, successful companies have a customer driven corporate culture. They know that it is customers that can make a company successful and all employees are very important in making the company successful. Successful companies listen to their customers and provide the products that give the customer what he wants (customer satisfaction) and not what the company wants to sell. Responsiveness to the consumer is the ultimate key. Employees must believe that what they do every day has an effect upon the business' success and that these effects are cumulative. Many a times, we hear from managers in corporate life "I know it doesn't make sense, but it's the policy as long as anyone remembers?" Dynamic leadership of successful companies always constructively challenges rules and assumptions in favour of customer satisfaction leading to building up of a successful company.

Culture is reflected in every activity, speech, habit, manners, behaviour, action, dress etc., and in fact in every turn in the organization. Projection of good culture ensures a healthy corporate life. Management is not only a technique, it is also a culture. An enterprise should be identified with its culture, like Mahatma Gandhi with Ahimsa



or Harishchandra with truth, similarly a corporate body with quality, schedule of delivery or ensuring payment promises etc. It is the management's responsibility to ensure the building up of a corporate culture comprising of :

- Commitment to honest productivity
- Planned performance and growth
- Informative, informing and informed, organization
- Consideration for others in partnership with the organization
- Participative management
- Good employee relations
- Good decisions and timely action
- Quality consciousness
- Mutual trust
- Futuristic outlook
- Helpful nature, inter-institutional and towards neighbourhood
- Cleanliness, timeliness, truthfulness, open home, orderliness, humility, creativity, learning, and sense of values.

9.2 CORPORATE SERVICES AUDIT

In this era of globalization, companies are always mired in tough battles for achieving greater efficiencies, differential products and services to improve their corporate services and enhance their sustainable competitive edge. The term "Corporate Services" refers to the activities that combine or consolidate certain enterprise-wide needed support services, provided based on specialized knowledge, best practices, and technology to serve internal (and sometimes external) customers and business partners. These services co-ordinate the diverse organizational units and helps them to focus on organizational goals by effectively exploiting resources and developing core competencies that enable an organization to keep its edge over its industry competitors. It sometimes amounts to combining operations with another competitor in the same industry to increase competitive strengths and lower competition among industry rivals.

The business world is now becoming increasingly information intensive and complex. Therefore, companies have begun to incorporate web-based services into the work place. This has opened up many new challenges and initiatives. This has radically affected many of the established functions. Some of them have been reduced, combined or eliminated. This also means that corporate boundaries are completely changing with advantageous partnering connections with outside service suppliers. Corporate services have now become integral part of the business value chain.

Corporate services are the support infrastructure of a company. These include public relations, customer assistance or call centers, training, engineering, human resources and procurement etc. to create new business value and help the company function more effectively by improving internal processes, managing customer relationships and extending the organization. The advantages of corporate services are productivity gains, cost savings and service improvements. The benefits of these services extend to core business areas in form of reduced costs, less inventory, less working capital requirements, improved procurements and higher profits. It also helps in much higher efficiency and productivity of the employees as new technologies can introduce an array of new possibilities with powerful computers and integration of database with web technologies. For example, if departmental managers were earlier receiving weekly or monthly reports to help them take critical decisions, all this information shall be available real time online now to help them to track the things which were important to them and take decisions.

The scope of corporate services audit extends to the critical examination of the different aspects of services and their extent that have been satisfactorily rendered by a corporate body, and of evaluation of degrees of responsiveness and awareness on the part of such enterprise. Thus the performance of management towards

consumers, employees, shareholders, community, fellow-businessmen and Government is studied separately and properly evaluated by management auditor. The areas of corporate services audit and the scrutiny and evaluation criteria can be categorized as follows:

- | | |
|------------------------|---|
| (i) Consumers | Quality goods in right quantities at right prices, place and time. |
| (ii) Employees | Pay, training, safety, welfare, industrial relations, etc. |
| (iii) Shareholders | Safety of investment, satisfactory return, appreciation. |
| (iv) Community | Social cost and social benefit, public relations. |
| (v) Fellow-businessmen | Business ethics and fair trade dealings |
| (vi) State | Compliance with the spirit of laws, fair trade practices, payment of taxes. |

The appraisal system of corporate services audit should consider the level of contribution a business entity makes to society and its business environment towards raising the quality of life through better product quality and services rather than profit maximization. The corporate services audit thus attempts to distinguish between the ends (i.e. profits) and means (i.e. services) of business and provides a new dimension to the concept of audit approach. It is the fulfillment of social responsibility of a business unit. Auditor's responsibility lies in evaluating the company's response to social needs.

9.3 CORPORATE DEVELOPMENT AUDIT

A corporate development audit is an independent objective study of an organization's capabilities. It aims at identifying strengths and weaknesses and moving toward state-of-the-art performance. A Corporate Development Audit gives a comprehensive picture of the status of corporate development effectiveness and highlights developmental needs. Many organizations use the corporate development audit to identify the state-of-the-art in business development in their industry and determine exactly how much they differ from that ideal. The resulting feedback report highlights all key findings, with specific recommendations for course correction or improvement.

Corporate development audit is a comprehensive task to assist the corporate management in various aspects of development through a process of systematic review and evaluation of long-term strategies of the company. Such corporate development audit assures that –

- (a) The various factors and forces constituting a corporate enterprise are the right kind and quality.
- (b) Communication remains the key to the functioning of an enterprise.
- (c) The pattern of departmentalization in an enterprise adopted in the past and proposed for the future for dealing with multidirectional responsibilities is fully responsive to circumstances and business environment.
- (d) The personnel problems are handled appropriately considering the overall objectives of development of the corporate enterprise.
- (e) The responsibilities of planning, coordination, motivation and control at functional management levels are discharged in proper spirit.

A corporate development audit is best performed by a team consisting of different experts of different disciplines as it requires multi-disciplinary approach. Large scale corporate enterprises offer opportunities to the conduct of corporate development audit. Contrary to other forms of audit – statutory or non-statutory (viz. financial audit, cost audit, efficiency audit, propriety audit, etc.) corporate development audit plays a vital role not only tying up the loose ends, but also to forge a link in the knowledge that emanates from different quarters and on the basis of different types of experiences in dealing with varied types of problems.

As the corporate development audit is more of an introspective nature, necessary initiation and support should come from a firm decision taken by the Board of Directors and its chairman. Moreover, as this audit highlights the corporate strengths and weakness, especially failures, inefficiencies and bottlenecks, it should be undertaken by a high-powered team with the corporation and acceptability of all those concerned with it.



Checklists in Areas of Corporate Development

Checklists on various areas of corporate development may be helpful in appraising the structural aspect of a corporation, detailed below :

A. *Check list on corporate planning*

- (a) Whether SWOT analysis has been made?
- (b) What are the corporate strengths and weaknesses in relation to price, product, quality, market share, distribution net work, after sales services, technology improvement, corporate structure and qualities of its members?
- (c) What are the opportunities and threats in relation to rivalry among existing firms, threat of new entrants, threat of opportunity of technical know-how, strategy of suppliers?
- (d) How are the threats overcome and opportunities availed of in the past?
- (e) Whether the "corporate image" is going to improve in near future?
- (f) What specific techniques are applied by the management for corporate planning, long and short term exercise?
- (g) Whether the corporate objectives and goals are clearly defined and qualified?
- (h) Whether the corporate planning premises and plans drawn up based on adequate information?

B. *Checklist on corporate objectives*

- (b) Whether the corporate objectives are clear and explicit?
- (c) Whether the different elements of the enterprise have separate objectives?
- (d) How are these objectives defined?
- (e) Are the objectives in writing?
- (f) Is there sufficient flexibility in then organizational design in the form of the responsiveness to changes taking place from time to time?

C. *Checklist on delegation of authority*

- (a) Whether there are clear lines of authority from top to bottom in the corporate enterprise?
- (b) Whether accountability has been properly coupled with corresponding authority?
- (c) Whether responsibility and authority in each position clearly defined in writing?
- (d) Whether the number of levels of authority kept minimum?
- (e) Whether duties assigned to the subordinates indicative as to what exact activities are expected from them?
- (f) Whether responsibility via delegation of authority created among the subordinates to complete the given task?
- (g) Whether the methods of delegation compatible to the organization structure?

D. *Checklist on span of control and management*

- (a) Whether span of control has been recognized in the organization?
- (b) Whether everybody in department report only to one superior?
- (c) Whether the accountability of higher authority for the acts of its subordinates is in accordance with current practices?
- (d) Whether the corporate management recognizes the following factors that affect span of control?

- (i) Degree of interaction between the units or personnel being supervised?
- (ii) The incidence of new problems in any department?
- (iii) The extent of standard procedures adopted?
- (iv) The extent of non-managerial responsibilities?
- (e) Whether the different activities and functions are grouped together in order to -
 - (i) Obtain the most effective use of men and facilities
 - (ii) Meet the objective in the optimum way?
 - (iii) To run the most economical operation?
- (f) Whether responsibilities are grouped, wherever possible, so that the overall control of a function can be established so as to hold the superior manager accountable?

9.4 EVALUATION OF PERSONNEL DEVELOPMENT

Market changes require continuous innovation within companies to enable them to grow successfully. Thus, successful personnel development aims at supporting and ensuring innovation processes of a company by efficient and targeted development of staff ultimately leading to organizational development. Personnel development, a vital aspect of corporate development is systematic training of managers and specialists to fill present and future needs for the company. It also helps further individual growth to ultimately facilitate corporate growth and expansion. The concept of personnel development is essentially long-range in nature. It is aimed at development of efficient, loyal and hard working employees. Since all the activities in an organisation are accomplished by the people, for the people and with the people, the aspect of personnel management gains significance.

Successful personnel development concepts must meet company-specific requirements and targets. Also, they should be efficient, economical and lean. Personal development teaches the staff as to how to become more productive and effective at work. Essentially, personal development is about having more control of self actions and emotions and staying motivated irrespective of situation or environment. Evaluation of personnel development may include the following criteria -

- (a) Pre-planning as an essential feature of human resource development.
- (b) Ascertaining manpower needs for appropriate education, training and development.
- (c) Ascertaining the difference between future needs and existing talent i.e. gap or imbalance.
- (d) Adopting a suitable programme of recruitment, selection, training and development to close the gap of imbalance.
- (e) Adequate manpower planning with an appropriate blending of manpower management policies and manpower management programme.

Scope of personnel function:

"Personnel Management" is that part of the management function which is primarily concerned with the human relationships within an organization. Its objective is essentially the maintenance of those relationships, which enable all those engaged in the undertaking to make their maximum personal contribution to the effective working of that undertaking. Therefore personnel management is concerned with managing people at work. It is concerned with employees, both as individuals as well as a group. It is essentially one of development of efficient, loyal and hard working employees. Personnel management is concerned with helping the employees to develop their potentialities and capacities to the maximum possible extent. The functional areas along with the scope of human resources management and development indicated below may be identified as the component of personnel function -

- (a) *Organization review and analysis* : Continuous review and analysis of organization's operation may be necessary in order to determine and develop appropriate work structure, roles and responsibilities, inter and intra-department relationship, and levels of authority.



- (b) *Manpower, planning, recruitment and selection* : Forecasting and planning is essential to needs an organization for a sufficient number of qualified personnel for manning its operations.
- (c) *Manpower training and development* : Appropriate methods and techniques of training and development may be adopted. Proper facilities and opportunities are to be provided for personnel to enable them to acquire necessary skills and knowledge to perform the jobs for which they are employed.
- (d) *Performance appraisal* : There should be proper measuring, rating and evaluation of performance of personnel, guiding employee development and promoting motivation, communication and equity.
- (e) *Employee remuneration* : This function includes developing and administering appropriate system of remuneration including job evaluation, wage and salary structure, incentive payments, fringe benefits and non-financial rewards.
- (f) *Employee services* : There should be satisfactory services relating to the safety, health and welfare of all employees, including social security plans and community development programmes.
- (g) *Administration and records* : This includes designing, implementing and controlling of adequate records and administrative procedures to provide useful and pertinent information for planning purposes and for the documentation for all personnel in service.
- (h) *Industrial relations* : It includes establishing appropriate procedures for the resolution for personnel and institutional differences by means of appropriate measures and machinery, e.g. standing orders, grievance procedures, conciliation, collective bargaining, and joint consultation.
- (i) *Auditing and research in manpower management* : These are the responsibilities of personnel management, which call for the attention of a management auditor.

9.5 CONSUMER SERVICES AUDIT

The primary responsibility of a business enterprise towards consumers is to make available the products of the right qualities at the right time, in right quantity, at the right place and right price. The consumer services audit critically examines and appraise management on these aspects of services. It is therefore an audit of public responsibility of business enterprise in relation to its customers and is a part of social audit. The audit is based on the philosophy that the role of business should be conducive to raising the quality of life through its contribution in terms of better product-quality and services.

Checklist on 'consumer services' evaluation:

A management auditor while examining the consumer services policies and practices in an organization may use the following questionnaire -

A. Products related policies and practices:

- (a) Do the products manufactured meet the needs of the customers of different classes, different tastes and different purchasing power?
- (b) Whether the prices are reasonable and consistent with the quality variations, efficiency variations?
- (c) Whether the prices include reasonable profit?
- (d) Whether the prices have been fixed under competitive market or monopolistic conditions subject of Government restrictions?
- (e) Whether detailed information regarding the product, service, company profile and policies etc. are adequately disseminated in order to ensure that the communication made to the customers regarding price, quality, services, etc. are truthful?
- (f) Whether after-sales service spare parts facility etc. enable customers to derive maximum satisfaction?
- (g) Whether the company undertakes adequate research in regard to products and customer behaviour so as to make their products more satisfactory to the customers?

- (h) Whether constant efforts are made for improvement of the product's use value as well as esteem value?
 - (i) Whether the management assumes responsibility of 'product development' function as a continuous exercise in relation to society in general and the consumers in particular?
 - (j) Whether the product development programme considers the factors of standardization, simplification and specialization?
 - (k) Whether such programme is undertaken to meet only the short-term demand or long-term requirements?
 - (l) Whether the company policies and practices, relating to the distribution of products among different sections of customers, fair and equitable?
- B. Customer Relationship
- (a) Whether the customer complaints are handled promptly and efficiently?
 - (b) Whether the company responds quickly to the customers' enquiries relating to product or services?
 - (c) Whether the labels of the products contain adequate information to help the consumers to appreciate quality and other characteristics of the products?
 - (d) Whether the company cooperates with the groups and associations representing customers?
 - (e) Whether the company provides useful suggestions and renders necessary assistance to 'consumer's cooperatives' for distribution of quality goods at reasonable price?
- C. General Considerations
- (a) Whether safety norms relating to products are maintained as per the accepted standards laid down by the statutory bodies, such as ISI, BSS, etc.?
 - (b) Whether performance guarantees are explicitly stated?
 - (c) How do the merits of the company's own products match the advantages to the consumers, if mentioned in the advertisements?
 - (d) Whether the technical data given in the sales promotional media specific and not ambiguous?
 - (e) How does the company ensure proper remedy against customer complaints when products are made available to the consuming public through a large network of distributors as well as retail outlets?
 - (f) Whether the policies and practices of the company are adequate to combat artificial scarcities?
 - (g) Whether all the "warranties" are explicitly stated? Is the procedure for invocation of warranty stated in unambiguous terms?
 - (h) Whether the fundamental aspect of servicing responsibility to consumer recognized by the enterprise as a policy measure?
 - (i) Whether there are instances of relaxation of policy norms in respect of responsibilities to customers even when the distribution of goods is made through middlemen?

9.6 AUDIT OF SOCIAL RESPONSIBILITY OF MANAGEMENT – ENVIRONMENTAL POLLUTION CONTROL

Environment includes entire biological, physical and social milieu in which man and other organisms are placed and no organism however simple or complex can survive on their removal from the environment. In order to make progress, man has produced destructive, hazardous and often irreversible changes in the environment on which he is totally dependent. With a view to improving living and nutritional standards, man has interfered with practically every sphere in natural ecosystem. The man-made pollutants that greatly influence the quality of environment are – metals, petroleum products, volatile industrial chemicals, heat and exhausts generated due to the burning of fossil fuels, radioactive species from reactors and nuclear reactors, organic and domestic wastes – as most of these are discharged untreated into the environment. Pollution is thus a kind of interference to the environment degradation. The problems of such environmental degradation – air, water, noise pollution, solid wastes, radiation hazards, thermal



pollution, are threats to wildlife, depletion and destruction of natural resources, etc. are all environmental crisis and threats affecting the delicate balance of natural ecosystem. Pollution can be described in the following ranges -

- (i) Pollution as any alteration of the environment.
- (ii) Pollution as the right of the territorial sovereign (it indicates the limit of pollution allowed within geographical borders of a state).
- (iii) Pollution as a damage to man and to the environment.
- (iv) Pollution as interference with other uses of the environment
- (v) Pollution as exceeding the assimilative capacity of the environment.

The level of pollution varies with the density of population and per capita income and inversely with the extent of recycling, technology and waste treatment. The different types, cause and effects of environmental pollution may be as follows -

(a) **Air pollution:**

Air pollution is the human introduction into the atmosphere of chemicals, particulates or biological materials that cause harm or discomfort to humans or other living organisms or damage the environment. Air pollution is caused by burning coal or crude oil like naphtha in power stations, smoke from factories, exhaust fumes from automobiles, solvent losses and agricultural chemicals, etc. Air pollution leads to deaths and respiratory diseases.

(b) **Water pollution :**

Water pollution is the contamination of water bodies such as lakes, rivers and/or oceans caused by effluents from breweries and tanneries, coal washeries, chemical plants, discharge of coolants from nuclear power plants, pesticides and agricultural chemicals. Water pollution affects public health and safety, causes damage to property and leads to many economic losses.

(c) **Noise pollution:**

Noise pollution is a type of energy pollution in which distracting, irritating or damaging sounds are freely audible and is caused by noise due to running of heavy machines, big aircrafts, aircraft, drilling machines, etc. Noise pollution may lead to loss of efficiency at work, loss of hearing and causes psychological disorders, even insanity.

(d) **Smell pollution:**

Discharge of industrial products, unclear garbage dumps, open sewers, etc. It affects physical well-being and even causes psychological disorders.

(e) **Thermal pollution:**

Large inputs of heated water from a single plant or a number of plants using the same lake or slow-moving stream can have harmful effects on aquatic life. Thermal pollution is radiation of heat generated by plants in industries. Warmer temperatures lower dissolved oxygen content and cause aquatic organisms to increase their respiration rates consume oxygen faster and increases their susceptibility to disease, parasites, and toxic chemicals. Thermal pollution affects ecological balance and thereby the inhabitants.

(f) **Visual pollution :**

Effluents from chemical plants and washeries are discharged into the waterways causing reduced visibility. Industrial fumes and dust causing loss of landscape attractiveness and strain to vision of pedestrians and motorists, may cause more road accidents and traffic deaths.

(g) **Climate pollution:**

Radiation of heat in highly industrial centres leading to "micro climate zones" causing deforestation, shortening plants growth and affecting surroundings. It affects ecological balance and causes damages to plant and surroundings.

(h) **Radiation pollution :**

Radioactive fallouts, leakage from nuclear reactors and prolonged exposures to small doses of radiation results in a bio-accumulative process, causes a significant chronic affect by increasing the rate of genetic mutation.

(i) **Soil/land pollution:**

Indiscriminate use of fertilizers and pesticides, pollution of soil with man-made chemicals, indiscriminate disposal of solid use etc. Due to pollution the quality of soil deteriorates to the extent that they fail to support vegetation. It affects the global climate also.

9.7 AUDIT CHECKS OF DIFFERENT FUNCTIONS

General

A management and administration auditor operating the following series of checks must remember that many of them are complementary. A correct picture of the effectiveness of any single function may not be completely obtainable from a review of checks in that area alone. Each function must be seen as a balanced part of a whole organization.

Directorial Checks

- (a) What routine reports are considered as directors' meetings and do these prima facie provide information for effective and efficient control of the business?
- (b) Do the directors receive projected information covering the various functions of the business, in addition to any figures which they receive to enable them to review the present performance of the business?
- (c) Is there evidence that directors established their control primarily on such projections secondarily on past records?
- (d) "Whether the Director review and approve the strategic and financial plans for achieving long-term success of the company.
- (e) What is the directors' policy for ensuring that the right kind of senior managers including CEO are engaged?
- (f) What interest do directors take in R&D? In particulars, if formal R&D facilities are available, what significant efforts are made to relate these to market research?
- (g) Have the directors set out the objects of the organization in writing?
- (h) Are all activities of the organization within the scope of its objectives?
- (i) Whether they have been briefed about major risks faced by the business and strategies for addressing these risks.
- (j) Do these include the ratio of capital aimed to be employed in the business, the objectives earning per share, the planned growth of the latter and the control of the former?
- (k) What control do directors exercise on the cash flow?
- (l) What is the method of determining budgets and the reporting system in connection therewith?
- (m) What steps have the directors taken to see that the objectives of the business are effectively communicated to their managers?
- (n) Have the directors defined the responsibilities of their various senior managers? Within such responsibilities have they set such senior managers defined objectives and established procedures for measuring the managers' performance against such objectives?
- (o) Do up-to-date organization structure exist? If so, do they show lateral as well as vertical relationships?
- (p) What control do directors exercise over senior management training?



- (q) What steps have been taken to compare the results of the various units of the organization with each other?
- (r) What control is exercised on transfer prices within the group organisation?
- (s) How do the directors discharge their responsibilities for the certification of the stock for balance sheet purposes?
- (t) Are special efforts made to control the management of technical and administrative service, as well as the management of operating departments?
- (u) If the articles of association require a directors' share qualifications, do the various members of the board hold the number of shares required?
- (v) Is the Register of Directors' shareholding maintained correctly?
- (w) Have the annual returns of the Register of Companies been made in accordance with statutory requirements?
- (x) Is the register of charges correctly maintained?
- (y) Has the statutory AGM (where applicable) been held, and has not more than the statutory allowable time elapsed since the last AGM?
- (z) Have extraordinary general meetings been called when required, and the requisite extraordinary and/or special resolution been passed where applicable?
- (aa) Check there are no loans to directors except those which are statutory allowable?
- (ab) Is the register of Directors and Securities correctly maintained?
- (ac) What is the attendance record of directors at directors' meeting?
- (ad) Are minutes of such meetings and of all general meeting carefully kept?
- (ae) Does a scrutiny of the directors' meetings minutes reveal that all necessary authorities and actions are obtained or taken, in accordance with statutory requirements, and the Articles of Association?
- (af) What efforts do the directors make to coordinate the activities of the various departments of the company, and to avoid duplication?
- (ag) What have the directors done to ensure the provisions of adequate management information and its dissemination?
- (ah) Whether the details of management reports structured according to the levels to be informed?
- (ai) Are the principles of management by exception applied to management information?
- (aj) How do the directors exercise functional control of the business?
- (ak) For function specific function is each director responsible?
- (al) What arrangement have the directors made for effective internal communication?
- (am) What arrangements have the directors made for effective external communication?
- (an) Do such arrangements made adequate provision for the upward flow of information.
- (ao) Are communications with customers and the general market satisfactory?

Managerial Checks

- (a) Are all level of managers competent in their functions?
- (b) What evidence is there that managers are up-to-date in their particular function?
- (c) Do all managers sufficiently and efficiently delegate their function?
- (d) Are there any example of delegation to the point where control is lost?

- (e) Are there adequately defined communication procedures?
- (f) Is it possible to identify the management styles of the senior managers and assess their effectiveness?
- (g) Is there adequate definition of staff responsibilities?
- (h) Is there a precise organizational structure?
- (i) Is there a system of management by objectives?
- (j) Are job specifications available for each or the majority of positions?
- (k) Are job specification/staff responsibilities revised as circumstances change?
- (l) Are methods of work defined, or partly defined in writing?
- (m) Whether or not they are in writing, how are they communicated to the staff?
- (n) What arrangements are there for keeping such instructions up-to-date?
- (o) Is there evidence of the enforcement of any authorizations required by such instructions, for example, for transactions that only transactions so authorized are allowed?
- (p) What training facilities or arrangements are there for:
 - (i) Managers?
 - (ii) Staff generally?
 - (iii) Newly joined staff?
 - (iv) Trainees?
- (q) Are career paths developed wherever possible?
- (r) Who is responsible for training?
- (s) Are the training tailored to the differing needs of the staff?
- (t) Have the possibilities of the various tutorial devices been investigated or exploited?
- (u) Are the efficient management for the recoupment of Training Board levies for all training carried out?
- (v) What means of measurement of staff performance exists?
- (w) How do managers plan the staff work load and control its flow?
- (x) Is there evidence that the generally recognized management techniques are used as appropriate?
- (y) Is there evidence of coordinated planning?
- (z) How effective are managers in their use of computer facilities? Is there evidence of action other than the passive receipt of computer processed statistics?
- (aa) How effective are the managers generally?
- (ab) Do managers use their time effectively?

Organisational Checks

- (a) How effective is the coordination and integration of the various departments?
- (b) Is there any evidence of duplication of function as between one department and another?
- (c) What is the management information system and who is responsible for it?
- (d) Is the information supplied well and logically presented in the various reports?



- (e) Is the information structured in such a way that the information given in the highest level reports is analysed in detail in the next level reports, and the information given in the second level reports analysed in the third level reports, etc.? If not, what is the detailed information retrieval system?
- (f) What strengths and weaknesses of the organisation are revealed by the scrutiny of the special reports?
- (g) Do special reports in general evidence of critical appraisal?
- (h) How is the budget structure related to operational responsibilities and how are expenditure controlled within the budget and remedial actions taken?
- (i) How is inflation catered for in budgets?
- (j) Is reporting based on the exception principle, or what other methods are used to highlight information areas requiring investigation?
- (k) Has each manager defined the responsibilities of his staff?
- (l) What forms do such definitions take? Are they available to other members of the staff so that they can see their relationship to each other?
- (m) Are common data files established for the use of several departments, particularly if the data processing is carried by computer?
- (n) What checks are there on the accuracy of the information in such files? Are there strict controls on their amendments?
- (o) Who has authority to amend such file information?
- (p) What security controls are there on the various levels of management information?
- (q) Is there evidence of good vertical information flow?
- (r) Is there also evidence of satisfactory lateral information flow?
- (s) Does the typical manager consult his subordinates as well as his superiors?
- (t) What opportunities do subordinates have for bringing their knowledge of detail to bear upon their superiors problems?
- (u) Is there evidence of an external communication policy?
- (v) Who has responsibilities for market communication? What are the principal policies and types in this respect?
- (w) What is the quality of trade communication? Does this extend to inter-firm comparisons?
- (x) Has management, generally a good credibility rating?
- (y) How is the business controlled in general?
- (z) Who is responsible for cash flow control? Is such control obviously effective?
- (aa) Especially in a vertically structured organisation what kind of planning takes place to synchronize the timings and capacities of the various units?
- (ab) What part does transport play in point (aa) and who controls this?
- (ac) In horizontally structured organizations, is sufficient advantage taken of comparative statistics and the promotion of health being made to standardize procedure in the same type of unit?
- (ad) In a conglomerate organisation, what financial controls are employed, in addition to those usual in other organisation, to take into account of the diverse production controls and market conditions?
- (ae) What degree of interchangeability of staff is possible? Do interchanges take place where economically viable?
- (af) In case of centralized organisation, is the response time to stimuli from the units adequate?

- (ag) What are the pros and cons for centralization in the organisation being studied?
- (ah) Is operational control of the various units largely decentralized? If so, what degree of central control is there and how is it organized?
- (ai) Is the central control adequate?
- (aj) Is the reporting structure from the operating units good?
- (ak) In a largely decentralized business, are services which would otherwise be uneconomically duplicated, provided at the center?

Capital Checks

- (a) Given that the directors ultimately control the cash flow in the sense of receiving reports and acting thereon, who actually controls the cash flow on a day to day basis?
- (b) How effective is the control of cash flow? Does the cash flow plan include control of important liquid assets other than cash? Is there evidence that temporary cash surpluses are used to gain short term interest, if necessary on a day-to-day basis?
- (c) Is the cash flow plan adequately linked to the sales budget finished goods, inventory budget and raw materials procurement, e.g. to reflect the cash requirements for inflation, a sudden demand for raw materials or extra labour, or to meet an unexpected sales upsurge? Is the control system capable of quick response to the mix and quantity of transactions affecting cash?
- (d) Is the working capital adequate?
- (e) Is the capital employed the optimum for the business?
- (f) Are the fixed assets valued carefully, especially in the sense that land and buildings can be substantially under valued in an inflationary environment and result in unrealistic business decisions?
- (g) What authorizations are required for the purchase of fixed assets and are they effective?
- (h) Is there an up-to-date asset register, and how are the assets physically identifiable?
- (i) How often is the asset register compared with the actual fixed assets position?
- (j) Where asset purchase control is exercised by value, is there evidence of any circumvention of the controls by splitting orders, or by rental or lease arrangements, for instance?
- (k) Is the right amount of technical appraisal being made before the purchase of fixed assets?
- (l) Is there a similar commercial appraisal relating to the acquisition of capital assets in each case to suit the business or the type of asset acquired, e.g. by purchase, lease or rental alternatives?
- (m) Is there continual appraisal of the fixed assets of the company? In certain circumstances, might it not be advantageous to sell property and lease it back from the purchaser?
- (n) Is the equity and loan capital adequate of the business?
- (o) How do the ratio of such capital compare with other business audited?
- (p) What is the earnings ratio of such capital employed in the business?
- (q) How do the earnings ratios compare with the business of the same type, in the same trade federation, etc.?
- (r) What is the capital structure in relation to ordinary and preference share and between equity and loan capital, and how does this gearing affect the business?

Data Processing Systems Checks

- (a) What are the main categories of data processing system? How are they divided between manual, mechanical and computer methods?



- (b) Has the right balance between such methods being achieved over all?
- (c) Are there adequate controls on the accuracy of all systems?
- (d) Is efficient use made in manual systems of aids such as add-listing machine, to check, for example, that the positing made to individual accounts total to the posting of a control account?
- (e) Are similar methods used in mechanical systems, e.g. to check that an accounting machine total agrees with a pre listed total of items posted on accounting machine?
- (f) Is use made of appropriate office techniques, such as photocopying, duplicating etc?
- (g) Is such equipment the best of the particular purpose for which it is being used?
- (h) Are the systems the best that can be devised?
- (i) Are computer systems used where appropriate, for example, a mini computer instead of a small selection of accounting machines?
- (j) Is the computer installation appropriate in size and staffing?
- (k) Is the computer process and its peripherals correctly balanced to the work load?
- (l) What control is exercised on input to an output from the computer installation, and if by a control system is this sufficiently independent?
- (m) Who has access to the computer installations?
- (n) Do programmers or system have any direct control of the data preparation unit?
- (o) Who has access to the computer installations?
- (p) How is the amendment of such programmes controlled?
- (q) What arrangements are there for the testing programmes before operational use?
- (r) Is there evidence of specific testing material rather than random selection of data from files?
- (s) How is systems testing organized?
- (t) Does the systems testing cover operating systems, files management, operation messages, data management, job control routines and fault detection?
- (u) Are recovery procedures featured in systems testing?
- (v) Does the systems testing cover throughout and response time under actual operating conditions and stimulated faults, with all possible volumes, types and combination of transactions?
- (w) What is the utilization of the various pieces of computer equipment?
- (x) What is the percentage of down time or misuse time, due to programming error, data error, or bad instructions,
- (y) How is data processing work scheduled through the computer?
- (z) If data transmission methods are used, are they necessary and do they justify their cost?
- (aa) What evidence is there of the economic use of computer?
- (ab) Is input editing by computer methods at the data preparation stage?
- (ac) Is the editing carried out on a special purpose data preparation computer?
- (ad) If so, is the cost justified by the extent of the utilization of the main computer on other data processing?
- (ae) Is the maximum use made of such methods as spoiling, multiprogramming and 24 hour shifts rather than extending the size of the computer?
- (af) Is there full documentation of all programs and systems?

- (ag) What controls are there on the magnetic base library?
- (ah) Are correct records kept of all program amendments?
- (ai) Have all such amendments since the last audit been checked?
- (aj) What methods of input to the computer are used?
- (ak) Are they the most efficient and economical for the installation in question?
- (al) Has the same method of input been considered from even remote locations?
- (am) If such methods of input are used, is the quicker processing really economically justified?
- (an) Are there adequate methods for 'capturing' all relevant data?
- (ao) Are the computer output methods efficient?
- (ap) What controls are there on the number of copies produced?
- (aq) Has careful consideration been given to the economy and effectiveness of exception reporting?
- (ar) Is output only actually printed where necessary, e.g. other output stored on magnetic media for random retrieval?
- (as) Has enough consideration given to graphical output methods and whether they would be a possible alternative method of information processing?
- (at) Are there satisfactory procedures for monitoring capital work flow?
- (au) Is there evidence for the continuance of 'private' manual system after computer systems covering the same ground have been introduced?
- (av) Is there difficulty in measuring data processing effectiveness against management plans?
- (aw) Is there adequate communication between the data processing section and user departments, and do liaison personnel change too frequently?
- (ax) Are data processing personnel inefficiently employed by staffing for peak levels, or arising from bad organisation or administration?
- (ay) Is there evidence of the general achievement of system development estimated times, bearing in mind that such times are often grossly under estimated and that development times tend to be much too long, leading among other things, to difficulties through changes of environment?
- (az) Are the computer systems designs generally too complex (efficient) at the expense of practical applications (effectiveness)?
- (ba) Is there evidence of adequate testing of programs and systems?
- (bb) Are problems being encountered with the manufacturer's software?
- (bc) Is staff turnover too high, even allowing for the traditional mobility of computer staff?
- (bd) Are reports late, hard to understand, inaccurate or too voluminous?
- (be) Do programme changes take too long to implement?
- (bf) Are there adequate security, back up and recovery procedures?

Standard Procedures Checks

- (a) Do standard procedures exist and are they in writing?
- (b) Who is responsible for keeping them up-to-date and are they in fact, so kept?
- (c) Do they adequately reflect changes in organization or responsibilities that have occurred since the date they were originated?



- (d) To whom are they circulated?
- (e) Are any checks carried out on behalf of general management to verify that the procedures are being adhered to?
- (f) If so, who is responsible for carrying out such checks and to whom does he report?
- (g) What determines whether it is the organization's policy in any set of circumstances to cover them by a standard procedure, e.g. are standard procedures indicated if coordinated action is required by more than one department, or may they be confined to one department only?
- (h) Are the standard procedures written as general instructions, leaving the details to be determined by individual department heads, or is every detail intended to be covered?

Planning Function Organisation Checks

- (a) Who is responsible for overall planning within the organisation?
- (b) If detailed planning is a staff function, what arrangements are there for making sure the planning does not get out of step with the planning policy makers?
- (c) What arrangements are there for information feedback from the operating units to the planners?
- (d) Is there a corporate planning unit ?
- (e) Is there a corporate stimulation model?
- (f) If not, how far is stimulation used in the planning function?
- (g) How accurate are the models?
- (h) How are the various models kept up-to-date?
- (i) To what use are the models put?
- (j) If the stimulation models are processed on a computer, is the terminal operated by a responsible person proficient in the function which is the subject of the model?
- (k) Are environmental surveys carried out, and how is such information is used?
- (l) Do the computer facilities provide an effective medium for interactive operation?
- (m) Are there adequate computer formula subordinates on call to the terminal operator?
- (n) Can backwards iteration be used on the computer model as a provided function, so enabling a planner to choose a required result and iterate to the elements that builds up to the final result?
- (o) Are there reasons of divergences from plans analyzed and the lessons learned used to modify later projection?

Purchasing Function Checks

- (a) Are there effective arrangements for minimizing the price of purchases, e.g. total purchases for multi location organizations, contract pricing, forward purchasing, quantity controls and correct timing?
- (b) What arrangement are there for controlling stock investment, in particular for controlling deliveries of raw materials, perhaps as a result of contracts placed for raw materials to be called off as required?
- (c) Is there evidence that the purchasing budget is developing on sound lines?
- (d) Is the budget, once prepared, used as an effective control on the purchasing function?
- (e) Are 'make-or-buy' proposals made to ensure optimum supply arrangements?
- (f) What is the system for synchronizing deliveries with the scheduled production requirements?
- (g) What follow-up is there on scheduled deliveries?
- (h) Is the receipt of goods adequately controlled?

- (i) What procedures are there for dealing with over-deliveries and under-deliveries?
- (j) Is there an effective system of inspection of materials received?
- (k) Are 100 percent of the goods received inspected, or are they sampled, or what other inspection method is used?
- (l) What accounting procedures are there for ensuring that rejected goods are debited to the supplier, either on return, or when scrapped, and for charging the supplier for any re-work done to make the goods acceptable?
- (m) Are there any statistical routines to determine the quality standards of suppliers and the rejection rates of goods supplied by them?
- (n) Are there similar routines to determine the supplier's relative ability to deliver on time?
- (o) Are standards conditions printed on the order forms, and do they adequately cover the purchaser for the commercial and business hazards applying to the purchase of goods? For example, do the conditions make clear whether the carrier is to be construed the agent of the seller or the buyer?
- (p) What system is used for validating incoming invoices for goods?
- (q) What method of control prevents duplicate payment for goods?
- (r) What purchasing measures are taken to rationalize cash flow and the amount of capital locked up in stocks?
- (s) Are there means for assessing buyers' workloads?

Inventory Control Function Checks

- (a) How are maximum and minimum stock controlled?
- (b) What customer service level is required?
- (c) How are these limits determined?
- (d) Within the permitted overall value coverage of stocks, how are permitted quantities of each stock item determined?
- (e) Is the stock of each item definitely related to the production program and the forecasted sales?
- (f) Is stock control also a function of the economic batch quantities?
- (g) How is raw material stock valued for production purposes and for balance sheet purposes?
- (h) How is the issue of stock controlled?
- (i) What are the systems of stock security?
- (j) What are the procedures to be followed when stock is found to be defective in store?
- (k) Who has authority to scrap the stock?
- (l) Who has authority to issue stock at other than the normal prices to production or to customers?
- (m) What control is there on samples?
- (n) Are all stock movements accounted for by any paper work?
- (o) Is there any security check that goods leaving the premises are covered by one or other of the permitted authorizing documents?
- (p) What system is in force for counting the stock to reconcile it with the book values, e.g. continuous stock checking?
- (q) What is the procedure for investigating any discrepancies in stock? Who has authority to consider any investigation closed?



- (r) In the case of discrepancies caused by system deficiencies, what follow up is there to ensure that the systems re improved?
- (s) What procedure is there for writing down the value of stock, say, for obsolescence?
- (t) If material has been issued to the shop floor as work in progress, what facilities are there in the production control system for establishing the point at which any stock deficiencies occur?
- (u) What controls are there on the over looking or work done by operators?

Production Function Checks

- (a) How are the production requirements for raw materials communicated to the purchasing function?
- (b) How is the production scheduled and controlled against the schedule?
- (c) Are these methods suitable for the type, size and complexity of the production processes?
- (d) What is the system for amendments to the production schedule?
- (e) How is rescheduling carried out when production is not to schedule, or there are machinery or labour troubles?
- (f) What methods are used to control the supply of raw materials for production?
- (g) How are labour requirement determined?
- (h) What system is there for ensuring good utilisation for machinery and what statistics on the subject are available?
- (i) Similarly, what is the system for ensuring good utilisation of labour and what statistics on this subject are available?
- (j) What is the inspection system during production and at the final product stage?
- (k) How are scrap items to be re-worked and controlled?
- (l) What methods are used for forecasting the production levels that will be required for the future months/years?
- (m) How is scheduled production broken down into its constituent items, to be produced at times which will make them available when required to merge with the part forming the finished product?
- (n) Are there efficient preventive maintenance programs for production equipment and machinery?
- (o) Is replacement cost information readily available for major items of plant?

Marketing Function Checks

- (a) Have clear marketing objectives been set? What are they?
- (b) What plans have been developed to attain those objectives?
- (c) What is the extent and nature of market research?
- (d) What principles apply to product planning?
- (e) What arrangements are therefore the planning and control of packaging?
- (f) How is the effectiveness of special sales promotions and advertising analysed?
- (g) Is the selling administration adequate for the type of market served?
- (h) Are transport arrangements suitable for the average size of order, the type of customer served and the pattern of distribution?
- (i) Are there economically satisfactory arrangements for such matters as minimum order, minimum quantities and particular item and packing carton quantities?
- (j) How is the sales force divided geographically, by specialization, according to category of customer, or by any other method?

- (k) How is the performance of salesman measured? Are short falls against targets identifiable to salesmen and specific customer?
- (l) What special incentives are there for salesmen?
- (m) How are customers' orders received?
- (n) Has a standard order form been considered?
- (o) Are any special support services given to customers, e.g. in the counting and replacement of stock, extended credit?
- (p) Are there routine facilities for collecting information from salesmen on competitors and the reaction of customers?
- (q) In the case of suppliers not dealing directly with the ultimate customer, e.g. suppliers who service wholesaler only, what arrangements are there for appraising the requirements of the ultimate customer?
- (r) Is there a meaningful analysis of customers' complaints and is such analysis effectively used in the engineering and product development branches of the business?
- (s) What is the coverage of the sales statistics? Are market forecasts compared with actual results in sufficient detail to identify the reason for discrepancies?
- (t) Are there comparative elements in such statistics with the budget, with the previous year with other representatives and with the other locations?
- (u) What are the systems for controlling the amount and rate of credit to customers?

Distribution Function Checks

- (a) Are there arrangements for deciding the most viable means of transport of finished goods?
- (b) What are these arrangements? Are they well known by the transport staff?
- (c) Did the arrangements result from some kind of the study of the transport problem and, if not, how were they developed?
- (d) Has the limit of liability for claims on the various carriers in relation to the need of customers been considered in the choice of carriers?
- (e) Have the economics of employing the company's own transport fleet been examined, particularly for high density and local deliveries?
- (f) Has an attempt been made to compound claims with the carriers, so avoiding administrative expense in dealing with abortive paperwork and lengthy investigatory procedures?
- (g) If the organisation uses its own transport fleet, have the pros and cons of contract hire or contract maintenance been considered?
- (h) Are decentralized warehouses part of the distribution system? If not, have the possible benefits of such an arrangement been considered?
- (i) Particularly where the organization's own transport and computer facilities are involved, has there been any attempt to optimize distribution patterns?

Financial Function Checks

Note : This check list assumes that a normal financial audit is also carried out.

- (a) Is there an internal audit department? If so, is it responsible to a person independent of the accounts department?
- (b) Does the internal audit department make regular reports and do these show a satisfactory position?



- (c) Are control checks made of the agreement of the financial records with the control records of other departments? For example, do the wages 'books' for the appropriate period agree with standards wages plus or minus variances of the operations processed during the period?
- (d) What are the checks on non-row materials expenditure, e.g. capital expenditure, rental and lease of equipment expenditure, personnel expenditure? Are personnel authorized to approve such expenditure listed, together with the appropriate limits, and does the accounts departments edit the paper work to ensure that proper approval has been obtained in each case?
- (e) Is there an appropriate system of approval for the engagement of labour, and do the accounts department check that this has been carried out before entering a person on the pay roll?
- (f) Is there a budgetary control system and what is the level of control exercised?
- (g) Is there evidence that management and supervisory personnel have been personally involved when their particular budget was fixed?
- (h) How effective is the budget system?
- (i) What is the method for presenting management and supervision with the actual results against the budgets? Is this effective?
- (j) Are the reasons for the discrepancies carefully ascertained and noted in the records?
- (k) How are especially serious discrepancies and the discrepancies which recur without apparent reconciliation brought to the attention of senior management?
- (l) Are the financial records so organized that the performance of senior managers can be measured?
- (m) Are the organizational relationships of the finance and accounts departments clearly documented, e.g. in organizational charts?
- (n) Are the duties of various posts within the above departments also documented, e.g. in job specifications?
- (o) In such specifications are the holders of the posts given all the authority they require to fulfill the responsibilities of the posts and are the lines of communication and liaison clearly laid down.
- (p) What are the credit control rules and are they being adhered to?
- (q) Do the staff understand their service role to operational departments and also their own rules within the overall service function?
- (r) What is the organization's policy on the acquisition and replacement of assets and the provision of funds for their replacement?
- (s) How are fixed and movable machinery, etc. assets physically controlled?
- (t) What evidence is there of effective security of accounting information, particularly that relating to personnel?
- (u) How is the personnel expenditure authorized?
- (v) How is the material expenditure authorized?
- (w) How is fixed asset expenditure authorized?
- (x) What controls are there on expenditure for labour?
- (y) Are the method of payment for goods economical and adequately controlled?

Personal Function Checks

- (a) Is there a manpower specification of the establishment of the organisation?
- (b) To what is the specification related e.g. level of sales, production?

- (c) Who has the authority to amend the manpower specification, other than in accordance with established rules, e.g. in proportion to sales?
- (d) How do staff measure up to this manpower specification?
- (e) Has job evaluation been carried out throughout the organisation and what are the arrangements for evaluating new jobs as they occur?
- (f) Do job specifications exist for all jobs in the organisation?
- (g) At what intervals is the structure, age, profession, grade, etc. of employees reviewed in relation to the manpower specification?
- (h) Are adequate personnel records properly maintained at all times?
- (i) If such records are kept centrally, what arrangements are there for access to them by remote managers and supervisors?
- (j) Whether they personnel records kept in such a way that selection by employee characteristic can be made therefrom?
- (k) Is there an active training programme?
- (l) Who is responsible for training managers
- (m) What arrangements are there for the management development?
- (n) Are adequate training records kept?
- (o) Are personnel records kept in such a way that trainable employees and the progress of those employees already being trained, can be monitored?
- (p) Are there definite career paths within the organisation?
- (q) How is basic training carried out?
- (r) Is this carried out "in-house", "externally" or a mixture of both?
- (s) Are promotable employees readily identifiable?
- (t) Are forecasts prepared of the numbers and structure of personnel that will be required to man the organisation at future dates?
- (u) Is there a definite personnel procurement program related to such forecasts showing how the difference between present and future structure is to be reconciled?
- (v) Is the case of direct operators; is there some definite relationship within the production schedules?
- (w) Is there a regular system of individual employee appraisal?
- (x) In the absence of a full employee appraisal system, is there some form of periodic review of employees?
- (y) Are employee made aware of the management's view of their performance, and given the opportunity to discuss the ways in which improvement can be made?
- (z) Is there a formal management by objective scheme?
- (aa) What controls are there on the hours of work completed, and the starting and finishing time of employees?
- (ab) Is the maximum use being made of "local" labour, e.g. by flexible shifts times to suit married women?
- (ac) Is absenteeism a serious factor in the organisation?
- (ad) How is absenteeism identified?
- (ae) Have any serious attempts been made to reduce absenteeism?
- (af) What is the employee turnover ratio?



- (ag) If high, what attempts have been made to reduce it?
- (ah) How the absenteeism and employee turnover ratio compare with other organizations in the same class of business?
- (ai) What security systems are there to safeguard the personnel records?
- (aj) Are the security systems effective?
- (ak) What controls are exercised over individual remuneration and its relationship to employees carrying out similar work in other departments?
- (al) If agreed sales are used which allowed some latitude to individual managers, what efforts are made to ensure a uniform approach to such matters?
- (am) Is there insufficient staff involvement due to inadequate means of disseminating information?
- (an) Is the organisation able to obtain and hold competent personnel?

Management Service Function and Data Processing Security Checks

- (a) What services are covered by the department?
- (b) Are the roles of the various specialists, their responsibilities, authorities and relationship adequately defined?
- (c) To whom does the head of the management services report?
- (d) To whom does the head of the computer department report?
- (e) Are the computer data preparation, operation, control programming and systems sections of the computer department independent of each other, reporting separately to the head of the computer department?
- (f) Are the duties of each section clearly defined?
- (g) Are there any opportunities for staff to carry out duties in a section other than their own?
- (h) Does the operational head being serviced by a computer system have the opportunity to approve the sample output as part of the testing facilities?
- (i) Is an operational log kept on the computer console typewriter or otherwise of all work processed on the computer and of the incidents that arise during the processing?
- (j) Who receives copies of such logs and are they carefully filled for future reference?
- (k) Are operation research techniques practiced?
- (l) Who controls operational research projects?
- (m) Are the regular process reviews of the operation research projects?
- (n) Are managers generally aware of the type of problem amenable to an operations research approach?
- (o) Who controls the work study department?
- (p) Under what circumstances are work studies carried out?
- (q) Is there a definite link between work study times and system of standard costs?
- (r) Are work study made as soon as possible to replace temporary times?
- (s) Are work study techniques used to assess job timings in the offices and administrative services as well as the production floor?
- (t) What other forms of work measurement or control are employed in the clerical and administrative section of the business?
- (u) Are systems, particularly computer system, audited in the design stage?

- (v) Are systems and procedures continuously checked to ensure that unauthorized modifications are now made?
- (w) How are projects controlled?
- (x) Are projects selected as a result of cost-benefit studies?
- (y) Is a project team leader always appointed?
- (z) Are the objectives of a project always specifically stated?
- (aa) What measurement of project progress are used?
- (ab) What arrangements are there for the periodical review of the progress of project?
- (ac) Who decides that projects have been completed to requirements?
- (ad) Are appropriate terms of reference established for all organisation projects?
- (ae) In the case of new organisation projects, is a "before" and "after" appraisal made to verify to what extent anticipated benefits or improvements have been achieved in practice? And by whom?
- (af) How is data collection and analysis carried out?
- (ag) What methods of investigations are used?
- (ah) Are tentative solutions to organizational problems tested against the experience of the managers directly concerned?
- (ai) How are new systems "sold" to operating management?
- (aj) How are operating staff trained in new methods and parallel run operation controlled?
- (ak) How effective in office management?
- (al) Is there evidence of the planning of office activities, as distinct from dealing with crises as they arise?
- (am) Is there evidence of coordination of the efforts of various elements of the office staff?
- (an) How good is the document flow between offices, for the various sections of a large office?
- (ao) Has general documentation between examined for readability, distribution and frequency?
- (ap) Are office services centralized where this is appropriate and economic?
- (aq) How efficient are the company's communication facilities?
- (ar) Are there written standard procedures?
- (as) How extensive are they, and to what distribution are they issued?
- (at) Is there an index?
- (au) What arrangements are there for keeping such procedures up-to-date?
- (av) Who issued standard procedures?
- (aw) What positive arrangements are there for the prosecution of work simplification programmes?
- (ax) In such programmes, are such aids as work distribution and process charts employed?

Equipment Checks

- (a) Who authorizes the purchase or rental capital equipment.
- (b) What are the procedures for specifying equipment required in potential suppliers and for obtaining competitive quotations?
- (c) Is recently obtained equipment in accordance with the specification, and what are the reasons for differences if there are any? Is inability to rectify difference due to failure to state the standards of performance required to fulfill the contract?



- (d) How does capital equipment generally relate to the needs of the business? For example, in the case of a computer installation, is the equipment of the right capacity and balance? Is the input and output equipment of the right kind and speed to suit the organization's requirements? Are the backup store facilities too large or too small?
- (e) In the case of equipment which have been replaced recently, or is about to be replaced relatively soon after acquisition, is there evidence that the original specification bore in mind reasonable development?
- (f) In related equipment in different parts of or locations of the organisation compatible either for mutual standby purposes or to facilitate the interchange of matter processed?
- (g) Is the existing equipment compatible with likely or possible development of the concern?
- (h) In large organisation, have special purpose or minicomputers been considered as viable as alternatives to the further use of a central computer?
- (i) In particular, where large data inputs are considered, has a separate small computer been considered as a part of the data entry, editing and validating procedures, prior to data entry to a large processor?
- (j) Is equipment being utilised adequately, e.g. by shifts covering 24 hours a day, or by multiprogramming, spooling and/or virtual storage techniques?
- (k) Are data collection systems too sophisticated for the needs of the business?
- (l) Is the most efficient copying equipment for the particular needs and volumes of the business being used?
- (m) What several types reprographic equipment are available, is each being correctly used in relation to such things as the number of copies required of the original, the intended recipients and the possibility of alternations and reruns etc.?
- (n) Is there the proper balance of office equipment and facilities, e.g. between manual, electric and automatic typewriters, and between secretarial services, copy typing and individual and central typing facilities, also, between the various types of calculators – adding machines, add listing machines and calculating machines with memories?
- (o) Is there the correct balance between computer programmes written in-house, obtained as packages, the use of standard modules in programmes written in-house, the utilization of the organization's own programming staff in relation to, say, obtaining a contract programme for a peak programming requirement not likely or recur, etc.?
- (p) Where a large number of copies of computer output are required, have the merits of producing an offset master and/or the use of micro film considered?
- (q) Have the alternative of rent, lease, or purchase various equipments been considered in relation to such factors as cash flow, capital employed in the business, rate of technological development and the break-even point of the replacement of old equipment by new, or in place of manual systems?
- (r) In relation to the foregoing, has the other major alternative of buying time on other organization's equipment or at service bureaux been considered?
- (s) In the case of lease equipment, are the precise terms specified under which upgrades, downgrades and termination of the use of the equipment are to be allowed?
- (t) Have advantages of using a relatively large computer by means of terminals and time sharing been considered, particularly by a relatively small organisation, or by a large organisation with special requirements?
- (u) Finally, in relation to points q, r and t, has the facilities management concept been considered, particularly in the case of a fairly young organisation that wishes to concentrate its own effort to pursuing its basic functions?
- (v) What methods are used for the efficient scheduling of the use of machinery?
- (w) What evidence is there of smoothing and accelerating the work flow through the business and the rationalization

of the location of machinery, departments and personnel in relation to the work flow?

- (x) What transport methods are used – own, common carriers, couriers, the post office? Is this the most effective mix of such facilities?
- (y) What consideration has been given to alternative methods of data transmission, if datapost, facsimile transmission, digital transmission by use of the switched network and/private line? The company's own transport, etc., and is their the most effective and optimum mix of such facilities.
- (z) Have agreed maximum response times been embodied in any maintenance service agreement for critical equipment?

Methods and Systems Audit Checks

- (a) What general control is there on methods and systems?
- (b) How efficiently is this exercised?
- (c) How are methods and systems knitted into the organizations?
- (d) What detailed control is there on the implementation of a system?
- (e) If the stages of implementation of a system are sufficiently critical and/or important, is advantage taken of such techniques as network analysis as one of the means of control?
- (f) How are methods and systems maintained and documented?
- (g) How are systems evaluated? In particular, if a new system has been introduced, is there a post-evaluation and is this compared with expectations which were put forward at the time permission to introduce the new system was sought?
- (h) Assuming that a system service is supplied to operating managers, in what form do the operating managers present their requirements to the departments supplying the system service?
- (i) Do such specifications clearly bring out the objects of the procedures required?
- (j) What is the method of development of a system from the point of the specification of his requirements by the operating managers?
- (k) Is it part of the introduction of methods and systems procedures to evaluate the degree of efficiency with which the objects of the present procedure are achieved, before drawing a comparison with proposed system?
- (l) When new systems and procedures are being contemplated, is specific provision made for the manner in which the changeover from the old system to the new is to be carried out, and in particular, how are phasing out stages of the old system dealt with?
- (m) How are systems depicted in discussion and subsequently communicated to the staff who will be required to operate them?
- (n) Are flow charts used as part of (m) above?
- (o) Are written standard procedures used as part of (m) above?
- (p) How is the documentation used in a new procedure explained to the users?
- (q) How effective are any written standard procedures issued as a means of communication of systems requirements?
- (r) Are they written in such a manner that rapid reference can be made to the parts that affect any particular employee in detail? At the same time, do they give an over all picture of the system of general management and facilitate initial reading of the procedures?
- (s) Where procedures require that authorization should be obtained at certain point before continuing with the system flow, are such authorizing signatories and the limits of their authority clearly set out or referenced in the procedure?



- (t) Most systems, require the initial setting up or taking over of files or records. What evidence is there that there has been adequate provision of the setting-up of such files and there is sufficient check on their accuracy before the new system commences?
- (u) What standard arrangements are there for the testing and parallel running of systems before passing them for operational use?
- (v) What evidence is there that new systems are generally implemented on schedule, and with the minimum of dislocation?
- (w) Are systems as a whole well integrated in relation to the business?
- (x) Do they use common data wherever this is practicable?
- (y) Do they supplement rather than oppose each other?
- (z) Is there an overall plan into which developing systems are fitted?
- (aa) Is there evidence that systems are being kept administratively up-to-date? Have they been modified to reflect changes which have taken place in the organisation or personnel?
- (ab) Is there evidence that systems are amended only in accordance with some authorized procedure?
- (ac) What arrangements are there for monitoring the work flow from the systems point of view of day-to-day control and also from the stand point of required reviews of appropriateness of method or managing in the light of new volumes, work peaks, or other aspects of work flow?
- (ad) What evidence is there that the social aspects of new systems have due attention?

Security Audit Checks

- (a) What security precautions are taken against leakage of those aspects of the organization's policy and planning, which are desired to be kept secret?
- (b) In particular, what security precautions are taken at boardroom level and in respect of secretarial facilities used by the board? Do this extend to carbon paper, plastic type writers ribbons and the magnetic media of automatic typewriters?
- (c) Is assess to research and development areas controlled?
- (d) Are the controls efficient and likely to be effective?
- (e) In particular, is special attention given to the security risks involved in the entry of service personnel to research and development areas?
- (f) What are the documentary and drawings security controls?
- (g) Who is responsible for the security of the company assets?
- (h) What measures are taken for the security of cash?
- (i) How is cash transferred to the bank and how are collections of cash/bank handled?
- (j) Who decides the actual route from the organization's premises to the bank?
- (k) What systems are there for identifying and controlling movable tools and other assets?
- (l) Is there a fixed asset register and who is responsible for maintaining it?
- (m) How effective is the control of receipts and issues of stock-in-trade and raw materials and the custody of such assets?
- (n) How often are stock-in-trade and raw materials items physically counted?
- (o) What action is taken when physically counted stock varies significantly from the book stock?
- (p) Who is able to authorize correction to the recorded book stock of an item?

- (q) What are the procedures for writing off damaged stock and revaluing obsolescent stock?
- (r) Is there an organized method of computer file preservation so that operator errors or equipment malfunctions causing loss of current file information can be rectified by reconstruction from preserved files?
- (s) Additionally, are important files copied at intervals suitable to their rate of change and stored remotely, so as to provide a backup in the event of major catastrophe such as fire, flood or explosion destroying current records?
- (t) Are magnetic file media stored away from the computer room in fire-resistant conditions when not in actual use?
- (u) Is the "no smoking" rule strictly observed in the computer room and the computer strong areas?
- (v) Are automatic fire detectors located in the computer room?
- (w) Are detectors also installed in such danger areas as underfloor cavities, ceiling, voids and air-conditioning ducts associated with the computer room and computer files strong areas?
- (x) Do such detection systems automatically trigger a fire brigade alarm?
- (y) Do they trigger an immediate discharge of extinguishing gas?
- (z) Does the fire detection system automatically switch off the air-conditioning installation in the event of fire, to avoid oxygen being unnecessarily fed into the flames?
- (aa) Is the computer installation located close to the hazardous areas such as those with a high fire risk of from which the public could throw missiles or bombs?
- (ab) Are there written instructions covering the action of computer operator staff in the event of major catastrophes such as fire, flood or explosion?
- (ac) Are the computer operator staff aware of the action they have to take in the event of a major catastrophe?
- (ad) Are the computer room walls and ceiling fire-resistant and water proof?
- (ae) Is suitable drainage provided in such locations as underflow cavities to disperse water which would otherwise flood the building?
- (af) Are hand fire-extinguishers readily available to computer room staff and do they know how to operate them?
- (ag) Do waste bins in the computer installation areas has self closing lids?
- (ah) Are adequate operating instructions available for all computer applications?
- (ai) Are computer legs maintained and carefully preserved?
- (aj) Are definite checks built into the application programmes to prevent miss operation and/or to assist the operator at appropriate stages of the processing?
- (ak) Are computer operators encouraged to report any unusual occurrences or unusual equipment operating characteristic?
- (al) Is access to the computer room and storage areas restricted?
- (am) Are the restrictions effective.
- (an) Are there a minimum of two computer operators on duty at any one time?
- (ao) Is there a preventive maintenance schedule in operation and is it being adhered to?
- (ap) How important is the uninterrupted provisions of computer services?
- (aq) If is important that there should be no interruption, say, in the case of on-line facilities for a bank net work, are duplicate facilities provided?
- (ar) In circumstances where an interruption is not critical, but continued provision of the service as soon as possible



is essential, have reciprocal standby arrangements been made with a similar local installation?

- (as) Are standby arrangements reviewed frequently to ensure that alterations in any of the installations have not invalidated the arrangements?
- (at) Is any necessary standby software that will be required if standby facilities are to be used, prepared and available for immediate use and transit?
- (au) Do catastrophe contingency plans exist?
- (av) What arrangements have been made to cover an interruption in the supply of electricity?
- (aw) Do these include protection against minute interruptions of the period of time required, say, to stand by generator?
- (ax) If the computer protected against uneven power supply?
- (ay) Are there large window areas unprotected from shattering?
- (az) Are all computer files, programs, etc. under the control of a librarian even if the size of the installation does not justify a full-time officer?
- (ba) Are issues and receipts into such library carefully recorded and the library otherwise kept locked?
- (bb) On a surprise basis, has a request for a computer printout of certain records been made and checked off by reference to recent transactions?
- (bc) Has selected specimen input data been processed by the computer against current programmes and records and the output checked for validity and accuracy?
- (bd) Are remote enquiry stations and local terminals kept securely locked when not in use?
- (be) Are the keys to such facilities strictly controlled?
- (bf) Are code words needed to gain access to the central computer, and are these changed from time to time?
- (bg) Has the efficiency of the security arrangements in connection with remote terminals been checked by an auditor trying to access the computer in an unpermitted manner?
- (bh) Are there standard instructions specifying the individuals who are authorized to amend or otherwise have access to computer information?
- (bi) Apart from the instructions given to staff covering immediate action in the event of a catastrophe, are plans laid for continuing operations after such a catastrophe?

9.8 CORPORATE DIVISIONS/DEPARTMENTS/FUNCTIONS

Evaluation of Purchase Management

The primary objective of purchase management is to procure raw materials, packing material etc. of the requisite quantity of required quality at reasonable cost at the right time. A management accountant may make a model questionnaire for evaluation of purchase management :-

- (a) What is the organisation for purchase function?
- (b) Whether the purchase policy is realistic?
- (c) Whether the purchase requirements are related to production schedules and dependent upon the level of invention?
- (d) How are suppliers selected and eliminated?
- (e) Whether regular and dependable suppliers are ensured?
- (f) Is there any system of purchase authorization?

- (g) Whether latest market information automatically collected regarding new spares, etc.?
- (h) Whether proper information is kept about price trends?
- (i) Whether regular comparison is made between average price paid and the corresponding average market price?
- (j) What are built-in-controls against misutilisation of purchasing powers?
- (k) How effective is the system of follow-up?
- (l) What is the system of executing emergency purchase?
- (m) What is the procedure followed for impact of raw materials?
- (n) Is there any proper coordination between purchase, stores and production?

Evaluation of Personal Management

The main objective of personnel function is to create such conditions in the organisation that the employees can put to best performances. The personnel manager has to assess manpower replacements, select, recruit, train and develop persons, ensure industrial peace, redress grievances of the workers, maintain discipline, keep various personal records and negotiate wage settlements. The performance of the personnel function policies may broadly be reviewed by asking the following questions :-

- (a) What is the organisation of the Personal Department?
- (b) Is the personnel department adequately staffed?
- (c) What is the status of personnel manager in the organizational hierarchy?
- (d) What is personnel policy? Is the organisation production-oriented or people-oriented? How does the top management look at its employees?
- (e) How are the manpower requirements assessed? Are manpower requirements defined clearly according to the degree of skills required?
- (f) What is the requirement policy? Are qualifications for each job specified clearly? Is the requirement procedure well designed?
- (g) What is the internal promotion policy? Are the employees given a chance to grow in the organisation itself through the objective tests to their qualifications and performances?
- (h) Are training programmes conducted regularly? Are they effective in updating the knowledge and skills of the employees? Are the opportunities for training adequate?
- (i) Are the training methods modern or scientific? Are they suited to the needs of the organisation?
- (j) Are proper records maintained for all workers? Is time keeping effective?
- (k) What is the procedure for dealing with the grievances of the employees? Are they encouraged to speak to the personnel manager?
- (l) How is the discipline maintained? How are the erring workers dealt with? Is there a uniform and stable policy of dealing with indiscipline and misconduct on the part of all the employees?
- (m) Are the various human cost properly analysed? Is the cost of labour turnover and absenteeism worked out periodically? Are attempts made to reduce labour turnover to optimum levels?
- (n) What effectively are labour welfare organized in the organisation?
- (o) Is there a machinery for dealing with the demands of the workers? Is legitimate union activities encouraged?
- (p) What is the extent of man-hours lost due to strike or lock out?
- (q) How these losses compare with the man-hours lost by similar organisation in the area?



Evaluation of Production Management

The main objective of production management is to turn out finished goods of requisite quality by making an optimum use of men, machine, and services. The productivity of such factors must satisfy the standards or norms set for the industry. The following check list will help the management auditor in evaluating production management :-

- (a) Is there an adequate system of production planning? Are production schedules drawn up to optimize various factors like plant capacity, raw materials, skilled labour, availability of funds, machine hours, availability of power, etc.?
- (b) Is there close coordination with sales department to ensure acceptability of the finished products by customers? How effective is the quality of finished products by customers? How effective is the quality control system?
- (c) How quickly are the customers' complaints dealt with ?
- (d) Is the production design properly worked out? Is there a constant review of the production design to improve the cost-benefit ratio?
- (e) Are the inputs and outputs of each process, operation or department linked up periodically?
- (f) Does the input-output ratio conform with the standard ratio?
- (g) What is the system of reviewing delays in production?
- (h) What is the frequency of accidents? Are safety measures adequate?
- (i) Is there a system of incentive scheme linked with the output of various production departments?
- (j) Have the incentive systems been designed on the basis of scientific studies?
- (k) How effective is control over idle time?
- (l) Is the production process review done periodically to explore the possibility of having more efficient production method?
- (m) Are the performances of service departments appraised periodically? Have standard efficiency factor worked out? Are they compared with actual efficiency ratios?
- (n) How effective is the management information regarding production function as a whole?

Evaluation of Research and Development Activities

With the evaluation of management practice, it is realized that somewhat different techniques and approaches are required for management audit to research and development activity as a separate area as it involves dealing with creative people not falling into a predictable pattern of accomplishment. Moreover, it requires operations and development efforts in a relatively unknown era. A management auditor of a company can appraise and evaluate the activities of research and development on the basis of the following checklist:-

- (a) What are the major achievements of the R&D?
- (b) What is the input-output ratio?
- (c) Whether the R&D scientist have actual operating experience in industry in order to visualize what they are developing?
- (d) What are strategic issues formulated at the Board level relating to industrial research?
- (e) How does the company formulate its approach on the annual outlay on research and development?
- (f) Whether the outlay on R&D is a fixed sum, a percentage of turnover, of profits, or capital investment, or on industry average?
- (g) Whether the Board of Directors identify or endorse the broad "types of research" to be undertaken to order to ensure that the efforts are concentrated in line with the defined goals?
- (h) Whether the R&D is considered as an independent department in the company?

- (i) Whether the R&D is viewed as a separate profit centre?
- (j) What is the level and extent of contribution of the company's profit through sale of technologies?
- (k) Whether there is proper coordination between the R&D cell and corporate planning cell?
- (l) Are the guidelines from the Board clear and workable?
- (m) How is the R&D budget formulated?
- (n) Whether the R&D results are properly recorded, classified and analysed?
- (o) How are the following areas of activity accomplished –
 - (i) Monitoring the existing projects?
 - (ii) Review of viability of projects in order to assign priorities?
 - (iii) Transfer of technology to project and operations sections?
 - (iv) Liaison with other departments and with outside agencies?
- (p) Whether the control scheme for a particular R&D programme realistic and effective in relation to–
 - (i) Long-term programme?
 - (ii) Short-term programme?
 - (iii) Periodical assessment of results with the predetermined budgets and correlated ideas?
 - (iv) Authorization of expenditure?
 - (v) Analysis of cost-effectiveness?
- (q) What successes and failures occurred in the past?
- (r) From commercial view point –
 - (i) Where savings were brought in by improved process?
 - (ii) What were R&D costs on new products developed as compared with sales and profits arising from these products?
 - (iii) What was the cost of R&D on improvement of existing products and resultant increase in sales and profits?

Marketing Audit and its Areas

Marketing audit is an independent examination of the entire marketing effort of a company, or some specific marketing activities covering objectives, programme implementation, and organisation for purposes of determining what is being done, appraising which is being done, and recommending what should be done in future.

The essential feature of marketing audit is that marketing audit is carried out periodically at regular intervals and not only when the company is facing marketing problems and difficulties. Such audit covers both marketing place and control and evaluate the basic framework for marketing action as also the performance within the framework. It covers the appraisal of the entire system and process of marketing taking into account all the elements of the marketing operations.

Marketing audit may be horizontal or vertical. Horizontal audit (also known as system level audit) covers a major part of marketing audit and evaluates a total appraisal of the marketing efforts of a company. Vertical audit (also known as activity level of audit) concentrates on single item of functions of marketing operation of a company identified by horizontal audit or otherwise and which becomes the subject of through examination and evaluation. The marketing audit covers the following areas –

- (a) **Objectives** : Marketing objectives should be clearly established. Majority of companies do not have clearly defined objectives except that achieving high sales volume or making high profit on the sales is the target. The search in audit of a clear objective will make the management aware of the gap in its operational policy if a well defined goal has not been already set up by the company.



- (b) **Programme** : The auditor should carry out an appraisal for the programme which the company has laid down for achieving the objective.
- (c) **Implementation** : The auditor will take up the examination of the company's implementation of the marketing programme.
- (d) **Organisation** : A suitable organisation assists in a success of a marketing plan. The audit should appraise the marketing organisation by reviewing the formal lines of authority and responsibility, delegation of authority, status of marketing head and his staff, adequacy of the personnel, proper manning of key tasks and assignments thereof.

Evaluation of Sales Management

The main objective of function of sales management is to create and develop customers and retain the position of the organisation in the market.

The following questionnaire will help in evaluating sales management –

- (a) How is the sales department organisation? Is it adequately staffed?
- (b) How specific responsibilities fixed for development of products in various areas?
- (c) What market forecasts are developed regularly? Are they reliable?
- (d) How does the growth in sales during the last five years compare with that of the industry as a whole?
- (e) What steps have been taken to increase the market share of the company?
- (f) Whether the system of appraising performance of sales division and salesmen objectives fair?
- (g) (i) Whether the salesmen's performance are linked with rewards?
(ii) Does the system motivate salesmen to give their best performances?
- (h) Are the sales budget realistic? Do they show detailed physical targets for each sales office?
- (i) What controls exist on the expenses incurred by salesmen?
- (j) (i) What is the percentage of sales returns and allowances?
(ii) Whether the percentage of sales returns declined over the year?
- (k) How does marketing manager keep in touch with the changing conditions in market? Are consumer surveys conducted regularly?
- (l) Is there a constant review of the order book?
- (m) (i) Does a proper control over stocks of finished goods exist?
(ii) Are the slow moving stocks reviewed periodically?
- (n) Is there a proper and realistic budget for advertising and sales promotion?
- (o) (i) Does a proper control over stocks of finished goods exist?
(ii) Is it reviewed periodically?
- (p) (i) What are the overall controls on outstanding?
(ii) Are they analyzed periodically?
- (q) (i) Are the ageing schedules prepared regularly?
(ii) What is the procedure of writing off bad debts?
- (r) (i) Are the distribution channels properly selected?
(ii) Whether operations research techniques have been applied in distributing products to minimize costs?

- (s) Is the system of after-sales services efficient?
- (t) What is the frequency of customer complains?
- (u) How frequently customer complaints are dealt with?

EVALUATION OF DISTRIBUTION FUNCTION

For evaluation of distribution function a management auditor should consider the following points –

- (a) Customer service goals and objectives.
- (b) Integrated material management.
- (c) Physical distribution network and operating plan.
- (d) Management information system.
- (e) Allocation of work activities and effectiveness in discharging the function.

The management auditor in order to carry out the review of "distribution policies" may design the following questionnaire –

A. Levels of customer service -

- (a) Are the levels of customer service realistic and competitive?
- (b) Does the management review –
 - (i) Customers' real service needs i.e. existing service levels?
 - (ii) Competitors abilities v. own abilities.
- (c) What is the step wise approach to survey and determine the customer service requirements?

B. Capacity configuration -

- (a) Whether the production, marketing and distribution capacities provide an economical means of meeting the necessary customer serviced criteria?
- (b) How are the capacity costs considered with respect to –
 - (i) Physical distribution operating costs?
 - (ii) Inventory levels?
 - (iii) Investment in distribution activities?

C. Staging of inventory -

- (a) What is the volume of each product at each stage?
- (b) Whether the flow of finished goods inventory through the distribution process reasonable within the acceptable service limits?

D. Transportation mode mix -

- (a) How is each transportation route in the distribution network identified?
- (b) How are the characteristics of traffic movement in the key routes determined?
- (c) Whether the present mode has been selected considering cost and service capabilities?
- (d) Does the distribution policy indicate integrated character in respect of :-
 - (i) the needs of the key group customers?
 - (ii) the requirements of key product market segments?
 - (iii) the market policy?



9.9 ENERGY AUDIT

An Energy Audit has been defined as an inspection, survey and analysis of energy flows in a building, process or system with the objective of instituting energy efficiency programs in an establishment. It consists of activities that seek to identify conservation opportunities preliminary to the development of an energy savings program. In other words, an energy audit is conducted to seek opportunities to reduce the amount of energy input into the system without negatively affecting the output(s). An energy audit also seeks to prioritize the energy uses according to the greatest to least cost effective opportunities for energy savings. In simple words, Energy audit means monitoring the energy efficiency of different equipment and process in a plant and looking into way by which the total sum of energy consumed can be cut down without affecting production or its efficiency.

In view of above, an energy audit is a fundamental step of the energy conservation programme in any industrial plant or energy consuming facility. Energy utilization and conservation play an important role in an industry in the current scenario of rapidly diminishing fossil fuels, explosive rise in the prices of crude oil and other energy sources and a possible switch over to alternative source of energy both for conserving energy costs and towards attempt for alternative sources of energy.

Energy audit and environment audit sometimes done together as both involve measurement of same parameters i.e., which are common to both. Thus for a boiler, for example, both would require measurement of fuel flow and air flow, CO₂ in the flue gas, etc. The energy-cum-environment audit allows a simultaneous consideration of energy and environmental aspects. As a result, it is possible to identify options to reduce the overall cost of energy as well as pollution control. Moreover, some of the principles of energy cost reduction and pollution control are also identical. Thus, an energy-cum-environment audit would eliminate the repetitive measurement of these common parameters. An energy-cum-environment audit is an analogous step of a programme aimed at conserving energy in an energy consuming facility and keeping its impacts on the environment within acceptable limits.

A few illustrations of possible sources for conserving energy are given below–

(A) Steam Generation:

- (i) Selection of boilers to achieve fuel economy
- (ii) Consider multiple or modular boiler units instead of one or two large boilers.
- (iii) Check against infiltration of air in furnace. Use doors or air curtains.
- (iv) Improve burner design, combustion control and instrumentation.
- (v) Use ceramic fibers in the case of batch operations.
- (vi) Match the load to the furnace capacity.
- (vii) Retrofit with heat recovery device.
- (viii) Investigate cycle times and reduce.
- (ix) Techno-economics of fuel substitution
- (x) Burn wastes if permitted.
- (xi) Improving the combustion efficiency
- (xii) Design of low temperature heat recovery system from the exhaust flue gas.
- (xiii) Use variable speed drives on large boiler combustion air fans with variable flows.
- (xiv) Increasing the generation to rated capacity
- (xv) Evaluating the efficiency of steam generation, fixing up the cost of steam generation and improving the efficiency
- (xvi) Design of monitoring system to effect economy

- (xvii) Preheat combustion air with waste heat.
- (xviii) Use boiler blow down to help warm the back-up boiler.
- (xix) Recycle steam condensate.
- (xx) Optimize boiler water treatment.
- (xxi) Add an economizer to preheat boiler feed water using exhaust heat.
- (xxii) Incremental loading of boilers
- (xxiii) Establish a boiler efficiency-maintenance program.

(B) Steam distribution:

- (i) Design of steam distribution system to augment the needs of process house.
- (ii) Redesign the existing steam distribution system to increase the production rate.
- (iii) Fix steam leaks and condensate leaks.
- (iv) Use back pressure steam turbines to produce lower steam pressures.
- (v) Use more efficient steam DE superheating methods.
- (vi) Ensure process temperatures are correctly controlled.
- (vii) Maintain lowest acceptable process steam pressures.
- (viii) Reduce hot water wastage to drain.
- (ix) Use waste steam for water heating.
- (x) Use an absorption chiller to condense exhaust steam before returning the condensate to the boiler.
- (xi) Use electric pumps instead of steam ejectors when cost benefits permit
- (xii) Repair damaged insulation. Insulate all flanges, valves and couplings
- (xiii) Insulate any hot or cold metal or insulation.
- (xiv) Establish a steam efficiency-maintenance program.

(C) Steam utilization:

- (i) Estimation of steam requirements, compare them with standard norms and suggest ways and means to reduce steam consumption.
- (ii) Selection and maintenance of steam traps.
- (iii) Insulate open tanks.
- (iv) Design of condensate recovery system.
- (v) Optimization of various process parameters to achieve steam economy in process equipment like stators, evaporators, dryers, etc.
- (vi) Selection of proper vacuum system to effect economy.
- (vii) Scheduling of process operations to achieve fuel economy.

(D) Electrical energy utilization:

- (i) Shift loads to off-peak times if possible.
- (ii) Minimise maximum demand by tripping loads through a demand controller
- (iii) Stagger start-up times for equipment with large starting currents to minimize load peaking.



- (iv) Use standby electric generation equipment for on-peak high load periods.
- (v) Relocate transformers close to main loads.
- (vi) Disconnect primary power to transformers that do not serve any active loads
- (vii) Export power to grid if you have any surplus in your captive generation
- (viii) Check utility electric meter with your own meter.
- (ix) Shut off unnecessary computers, printers, and copiers at night.
- (x) Improving load factor (xi) Improving power factor
- (xii) Use water-cooled condensers rather than air-cooled condensers
- (xiii) To study the matching of motors and driven equipment and suggest modifications
- (xiv) To assist in selection of high efficiency motors
- (xv) To suggest better variable speed drivers
- (xvi) Better operation, maintenance of compressed air system
- (xvii) To study and suggest measures for improving the system, the system efficiencies of refrigeration and air-conditioning system.

(E) Total energy system:

- (i) Shut down spare, idling, or unneeded equipment.
- (ii) Make sure that all of the utilities to redundant areas are turned off – including utilities like compressed air and cooling water.
- (iii) Install automatic control to efficiently coordinate multiple air compressors, chillers, cooling tower cells, boilers, etc.
- (iv) Use the lowest possible hot water temperature.
- (v) Do not use a central heating system hot water boiler to provide service hot water during the cooling season – install a smaller, more efficient system for the cooling season service hot water.
- (vi) Consider the installation of a thermal solar system for warm water.
- (vii) Use multiple, distributed, small water heaters to minimize thermal losses in large piping systems. (viii) Use freeze protection valves rather than manual bleeding of lines.
- (ix) Consider alternatives to high pressure drops across valves.
- (x) Assess the heat and power requirements and study the feasibility of incorporating cogeneration system to affect higher thermal efficiency of the system and give specifications of boilers, turbines and the related auxiliaries.

(F) Diesel exhaust recovery:

- (i) Study the techno-economic feasibility of recovering heat from diesel exhaust and assist in implementation.
- (ii) Turning up diesel generating sets for highest efficiency.

9.10 PRODUCTIVITY AUDIT/EFFICIENCY AUDIT

The Productivity audit is basically an analysis of the productivity of the resources deployed by any organization. It is generally done to generate information about the status of productivity in the organization for the purpose of determining the scale of efficiency and effectiveness of 'resource utilization'. The term 'resources' here would

include not only "money" but also "men", "machines", "materials" and "methods". In other words, the objectives of productivity audit is – (a) to attain optimum result, and (b) to improve on the benchmarks.

This audit would generally comprise – (a) comparison of expected returns on utilization of the resources vis-à-vis the actual returns; (b) comparison of optimum returns on utilization of the resources vis-à-vis the actual returns; and (c) the steps taken to improve benchmarks of returns and the utilization.

The term 'Productivity' is normally attributed only to the "productivity of labour" or "efficiency of labour" alone. But productivity audit is actually "productivity of every resource employed". Productivity audit is done by – (a) Ratio analysis – Return on capital employed – Return on sales – Turnover ratios of fixed assets, current assets, inventories, category-wise debtors etc.

- (a) Capacity utilization of plant, machinery and equipment against available capacity.
- (b) Productivity analysis of man (labour) hours in time and cost.
- (c) Material consumption against norms and benchmarks.

The following ratios are generally used in measuring productive efficiency of the resources deployed and utilized:

Resources Deployment

- (i) Capital employed per capita
- (ii) Capital employed per unit of product
- (iii) Gross profit to capital employed
- (iv) Net profit to capital employed
- (v) Debt equity ratio
- (vi) Net worth and long-term debts to gross fixed assets
- (vii) Net worth and long-term debts to net fixed assets
- (viii) Debts to fixed loans
- (ix) Debts to floating loans
- (x) Current assets to current liabilities
- (xi) Net working capital
- (xii) Total inventory to capital employed.

Resource Utilisation

- (i) Capacity utilisation – Installed capacity: Utilised capacity of machines (by units)
- (ii) Capacity utilisation – Installed capacity: Utilised capacity of machines (by machine hours)
- (iii) Machine time available : Machine time utilized
- (iv) Machine time consumed : Per unit of product (individually)
- (v) Machine time consumed : Per capita
- (vi) Gross fixed assets : Turnover
- (vii) Net fixed assets : Turnover
- (viii) Inventories : Turnover (inventory turnover)
- (ix) Raw materials : Turnover (No. of days of stock)
- (x) Work in process : Turnover (No. of days of stock v. cycle time)
- (xi) Finished goods : Turnover (No. of days of stock v. lead time)



- (xii) Labour time consumed : Division-wise
- (xiii) Labour time consumed : Product-wise
- (xiv) Labour time consumed : Product group-wise
- (xv) Turnover per capita
- (xvi) Value added : per capita
- (xvii) Indirect labour : Direct labour number
- (xviii) Indirect labour costs : Direct labour costs
- (xix) Levels of management.

9.11 PROPRIETY AUDIT

Propriety audit stands for verification of transactions in the best interest of the public, commonly accepted customs and standards of conduct. The term "propriety" has been defined by Kholer as "that which meets the tests of public interest, commonly accepted customs and standards of conduct and particularly as applied to professional performance, requirements of Government regulations, and professional codes." The tests boil down to consideration of financial prudence and economy, instead of too much dependence on documents, vouchers etc. It shifts the emphasis to find the wisdom and appropriateness of expenditure, rather than verifying whether it has been duly authorized or evidenced by proper vouchers etc.

In other words, the propriety audit seeks to ensure that the planned expenditure would yield the optimum returns and there is no other better alternative available. It seeks to ensure that the expenditure is not only appropriate to the circumstances of each case, it has indeed achieved the objectives for which it has been incurred. The audit of public sector undertakings as undertaken by the Comptroller and Auditor-General of India is the best example of propriety audit.

The auditors, while conducting the propriety audit, should in any case ensure observance of the following Canons of Financial Propriety:

- (a) The expenditure should not, prima facie, be more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public money as a person of ordinary prudence would exercise in respect of expenditure of his own money.
- (b) No authority should exercise its power of sanctioning expenditure to pass an order which will be directly or indirectly to his own advantage.
- (c) Public money should not be utilised for the benefit of a particular person or section of the community unless:
 - (i) The amount of expenditure involved is insignificant or
 - (ii) A claim from the amount could be enforced in a court of law or
 - (iii) The expenditure is in pursuance of a recognized policy or custom.
- (d) The amount of allowances (e.g. travelling allowances) granted to meet the expenditure of a particular type, should be so regulated that these are not on the whole sources of profit to the recipients.

The Cost Audit Reports can be termed as propriety audit as these reports seeks to ensure that actual expenditure at each stage is appropriate and optimum returns have been achieved. The cost auditor always aims at ensuring that the actual expenditure should not be prima facie more than what the occasion demands. The cost auditor has to report on matters which appear to him to be clearly wrong in principle, cases where the company's funds have been used in a negligent or inefficient manner, arm's length pricing of related party transactions, etc. These are the areas where the propriety aspect is involved and therefore cost audit may be in the nature of "propriety audit".

9.12 CORPORATE SOCIAL RESPONSIBILITY (CSR) AUDIT

Social audit is generally defined to be the audit of data or information depicting social performance of a business in contrast to its normal economic performance as measured in financial audit. A lot of research and experimentation are being conducted to device techniques or models, which can measure the contribution of an enterprise to the society. These developments result from an increasing realization of the fact that business undertakings have social responsibilities also and that the performance as a whole should be seen in this context.

A corporate social audit is an assessment of company's performance on corporate social responsibility objectives. It evaluates measurable goals intended to help the business meet the expectations stakeholder groups have regarding social and environmental responsibilities. Balancing social responsibility with business performance is imperative in today's business arena.

Corporate Social Responsibility (CSR) under Companies Act, 2013

The concept of CSR rests on the ideology of give and take. Companies take resources in the form of raw materials, human resources etc. from the society. By performing the task of CSR activities, the companies are giving something back to the society.

India's new Companies Act 2013 has introduced several new provisions which change the face of Indian corporate business. One of such new provisions is Corporate Social Responsibility (CSR).

Section 135 deal with CSR. As per Section 135(1), Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

Section 135(5) states that The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two percent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:

Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities:

Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation.—For the purposes of this section "average net profit" shall be calculated in accordance with the provisions of section 198.

"Net profit" means the net profit of a company as Per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely :-

- (i) any profit arising from any overseas branch or branches of the company' whether operated as a separate company or otherwise; and
- (ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act:

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, (1 of 1956) shall not be required to be re-calculated in accordance with the provisions of the Act:

Provided further that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381 read with section 198 of the Act.

Ministry of Corporate affairs vide Notification dated 27.02.2014, has issued Companies (Corporate Social Responsibility Policy) Rules, 2014, which is effective from 01.4.2014.



As per Rule 2 (c) "Corporate Social Responsibility (CSR)" means and includes but is not limited to

- (i) Projects or programs relating to activities specified in Schedule VII to the Act or
- (ii) Projects or programs relating to activities undertaken by the board of directors of a Company (Board) in pursuance of recommendations of the CSR Committee of the Board as Per declared CSR policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

Further MCA vide another Notification dated 27.02.2014, made the following amendment to the Schedule VII of the Companies Act, 2013, effective from 01.04.2014 as mentioned below.

- (1) In Schedule VII, for items (i) to (x) and the entries relating thereto, the following items and entries shall be substituted, namely:-
 - (i) Eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;"
 - (ii) Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;
 - (iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centers and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
 - (iv) Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water;
 - (v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
 - (vi) Measures for the benefit of armed forces veterans, war widows and their dependents;
 - (vii) Training to promote rural sports, nationally recognized sports, Paralympic sports and Olympic sports;
 - (viii) Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the scheduled castes, the scheduled Tribes, other backward classes, minorities and women;
 - (ix) Contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
 - (x) Rural development projects.

The Schedule VII was again amended by Notification dated 06th August, 2014, making the following amendments in Schedule VII of the said Act, namely:-

- (1) In Schedule VII, after item (x), the following item and entry shall be inserted, namely:-

"(xi) slum area development.

Explanation.— For the purposes of this item, the term 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force."

- 2. This notification shall come into force on the date of its publication in the Official Gazette.

CORPORATE SOCIAL RESPONSIBILITY (CSR) AUDIT- PROCESS

A CSR audit program can cover all or any of the following risks: -

- Effectiveness of the operating framework for CSR implementation
- Effectiveness of implementation of specific, large CSR projects
- Adequacy of internal control and review mechanisms
- Reliability of measures of performance
- Management of risks associated with external factors like regulatory compliance, management of potential adverse NGO attention, etc.

A CSR Audit should cover the following points:

- Human Rights: Fundamental Human Rights, Freedom of association and Collective bargaining, Nondiscrimination, Forced labor, Child labor
- Business behavior: Relations with clients, suppliers and sub-contractors, Prevention of corruption and anti-competitive practices
- Human Resources: Labor relations, Working conditions including steps taken for preventing accidents and health hazards, health and safety measures including compensation in case of any accidents, career development and training, Remuneration system that motivates the employees.
- Corporate Governance: Board of Directors, Audit and internal controls, Treatment of shareholders, Executive remuneration
- Environment: Incorporation of environmental considerations into the manufacturing and distribution of products, and into their use and disposal, effect on pollution, pollution control measures undertaken,
- Community Involvement: Impacts on local communities, contribution to social and economic development, General interest causes, creation of social infrastructure like roads, schools, hospitals.

Study Note - 10

INTERNAL CONTROL, INTERNAL AUDIT AND OPERATIONAL AUDIT



This Study Note includes

- 10.1 Internal Control - Concept
- 10.2 Scope of Internal Control
- 10.3 Structure of Internal Control
- 10.4 Limitations of Internal Control
- 10.5 Evaluation of Internal Control
- 10.6 Internal Control Questionnaire
- 10.7 Internal Control and Internal Auditor
- 10.8 Origin of Internal Audit
- 10.9 Internal Check and Internal Audit
- 10.10 Internal Audit and its Scope
- 10.11 Statutory Auditors and Internal Auditors
- 10.12 Assessment of Adequacy of Internal Audit Function
- 10.13 Auditing Government Agencies
- 10.14 Provisions of Internal Audit under Companies Act 2013
- 10.15 Qualities of Good Internal Auditor
- 10.16 Internal Audit – India
- 10.17 Operational Audit
- 10.18 Budgetary Control System
- 10.19 Capacity Utilisation
- 10.20 Inventory Control
- 10.21 Management Information System
- 10.22 Audit Planning, Programme, Working Papers and Reporting to Management
- 10.23 Internal Audit Programme - Industries Specific

10.1 INTERNAL CONTROL - CONCEPT

A control can be defined as *any action taken by the management to enhance the likelihood that established objectives and goals will be achieved*. It results from management's planning, organizing, and directing to ensure that an organization is working toward its stated objectives. It is known by various names like management control, internal control etc.

This can be explained other way also. The 'Corporate objectives and goals' are the statement of corporate intent (for example, to increase the market share of the product by 15% in the next financial year). To achieve this 'corporate objective', management defines its own action as how the corporate objectives will be met i.e., 'management objective' (for example, market share will be increased only by leveraging some of the customers' current and future wants and needs). Internal control ensures that the 'action plan' to achieve management objectives is properly planned and executed (periodic checks will be made of the integrity of the information forming basis of the action plan regarding customers' current and future wants and needs and steps taken by marketing staff for full use of data mining tools in order to satisfy their information needs). Control responsibility is clearly management's job and encompasses planning, organizing, and directing.

In a narrow sense *internal control* is often seen as involving certain checks and procedures to prevent direct financial fraud or misappropriation of assets. They are sometimes also seen as mere accounting guidelines. But now days the concept of internal control has undergone complete change. It is now defined to include various methods and procedures to safeguard the assets of an organisation, to ensure that accounting and statistical data produced are reliable and accurate ensuring greater efficiency in operation. According to W.W. Bigg, internal control "is best regarded as indicating the whole system of controls, financial or otherwise, established by the Management in the conduct of a business, including internal check, internal audit and other forms of control". So it is clear from the above definition that the internal control is a very wide term which includes financial and other forms of control including internal checks.

The Information Systems Control & Audit Association (ISACA) defines 'internal control system' as "The policies, procedures, practices and organizational structures, designed to provide reasonable assurance that business objectives will be achieved and that undesired events will be prevented, or detected and corrected." The Institute of Chartered Accountants, England and Wales, defines Internal Control as "By internal control is meant not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible the accuracy and reliability of its records".

In view of above, Internal control system can be defined to be the policies, practices, procedures, and tools designed with the objective to: (1) safeguard corporate assets, (2) ensure accuracy and reliability of data captured and information products, (3) promote efficiency, (4) measure compliance with corporate policies, (5) measure compliance with regulations, and (6) manage the negative events and effects from fraud, crime, and deleterious activities.

10.2 SCOPE OF INTERNAL CONTROL

It is clear from above that internal control is an essential pre-requisite for efficient and effective management of any organisation and is therefore, a fundamental ingredient for the successful operation of the business in modern days. In fact, an effective internal control system is a critical success factor for any organization in the long term. They are indispensable tools for the ever-increasing risks, exposures, and threats to accounting systems, data, and assets. It embraces the whole system of controls – financial, operational or otherwise, established by the management in the functioning of a business including internal check, internal audit and other forms of control. In fact, internal control has now been recognized as fundamental and indispensable to modern auditing. Thus internal control has its all-embracing nature and is concerned with the controls operative in every area of corporate activity as well as with the way in which individual controls interrelate.

The scope of internal control, according to the aforesaid definitions, extends well beyond accounting control. Thus, the latest definition of internal control encompasses operational controls like quality control, work standards, budgetary control, periodic reporting, policy appraisals, quantitative control, etc., as all parts of the internal control system. In an independent financial audit or the statutory audit, the auditor is concerned mainly with the financial and accounting controls. However, in an operational audit (as part of internal controls), the auditor reviews all the controls including operational functions. The internal controls can be broadly classified into following four main categories: financial & accounting controls, administrative controls, operational controls and compliance controls.

- (i) **Administrative control** – Administrative controls include all types of managerial controls related to the decision-making process. An example of administrative controls is the maintenance of records giving details of customers contacted by the salesmen.
- (ii) **Operational control** – This is exercised through "management accounting" techniques viz. budgetary control, standard costing etc.
- (iii) **Financial and Accounting control** – This control refers primarily the management plans, objectives and procedures that are concerned with the safeguarding of assets, prevention and detection of fraud and error, accuracy and completeness of accounting records, and timely preparation of reliable financial information.
- (iv) **Compliance control** - These controls aim at ensuring compliance with applicable laws and regulations. These Controls also help to ensure compliance with laws regarding the system and intellectual property.

10.3 STRUCTURE OF INTERNAL CONTROL

There is no uniform or identical in its approach of internal control in all the organizations. It often varies in concept and applications, having regard to the following:

- (a) Type of business
- (b) Magnitude of the business
- (c) Infrastructure available in the organization.
- (d) Potentiality of the human resources and their outlook.

Therefore, while designing an internal control system, the following factors must be considered to ensure greater chances of successful internal control system.

- **Segregation and Rotation of duties:** It is very necessary for successful internal control system that no one person handles the complete transaction i.e., those who physically handle assets are not those who record the asset movements also. The systems are so designed that no single individual is responsible for all the stages involved in a transaction i.e., duties are allocated in such a way that no single individual has an exclusive control over any one transaction or a group of transactions. Similarly, the people responsible for authorizing these transactions or reconciling of the records should also be different i.e., the work done by one person is either complementary to the work done by other person or the accuracy or correctness of work done by one person is independently checked by another person. The broad functions which are generally segregated are:

- (a) Execution of transactions;
- (b) Authorization of transactions;
- (c) Maintenance of records and documents; and
- (d) Physical custody of related assets.

Apart from segregation of duties, it is sometimes considered more desirable to rotate the duties of various officers and staff in an attempt to ensure that a fraud or error, if any may not remain undetected for a very long time. It also ensures that a person does not develop a vested interest by holding to a post for a very long time. In addition, it removes the impression of indispensability about an employee. This also ensures that the job profile of each post is well defined because employees can be rotated only if the content of each respective job is well defined.

- **Competence and integrity of people:** Internal control systems are not an end to themselves unless these systems are manned by the competent people, who are honest enough to consistently do so. The controls to be successful and effective necessitate the need for competent people to enforce such controls. In other words, the presence of detailed procedures may have no meaning unless these procedures are carried by the competent people, who can also envisage the changes required in the system over a period of time.
- **Appropriate levels of authority.** A common error usually made is to grant too much authority within control boundaries. Sometimes, this is deliberately done to expedite the things or to handle the emergencies. This is sometimes done to reduce the number of people i.e., cost reduction. However, controls to be effective require the authority to be granted on a need-to have basis only. If there is no need for a particular person to have a specific authority, he/she should not be granted such authority.
- **Accountability.** The internal controls to be successful presuppose that there is full accountability for all the decisions taken and there are controls present, which allow the determination with acceptable level of confidence of a person taking particular decision or authorizing particular transaction or took specific action. However, mere presence of these controls may have no meaning or may give a false sense of security unless strict action is taken every time, a discrepancy is noticed. Other wise these controls may be left with no meaning.

- **Adequate resources.** Controls that are enforced with inadequate resources (manpower, finance, equipment, materials, and methodologies) will generally fail whenever they come under stress. Therefore, it is very necessary that minimum resources necessary to enforce the controls must always be present to enable the controls to be successful and effective.
- **Supervision and periodical updation:** Unfortunately, many people prefer to work only if they are being supervised or watched. It is, therefore very necessary for the controls to be adequately supervised and periodically updated in line with changing environment to be effective and successful. For example, in case of banks, if new service i.e., internet banking is also being started, it is very necessary that internal control system is also updated accordingly.

10.4 LIMITATIONS OF INTERNAL CONTROL

An important ingredient in development of an effective internal control system aimed at the achievement of management's objectives is to ensure that the organization has adequate relevant policies accompanied by effective monitoring and reporting mechanism. Moreover, while establishing the management objectives, the management must take into consideration the cost of attempting to achieve them. In other words, the cost of achieving objectives must be less than the anticipated benefits to be derived by achieving the objectives. One extreme is to achieve objectives "As quickly as possible" implying zero controls, while other extreme of achieving of objectives with "No errors" implies strong internal controls covering all aspects of objective. Controls must therefore be practical, useful, achievable, and compatible with both operating and control goals and there is always a trade-off between cost and benefit. Since all controls cost resources in terms of money, personnel, equipment, and time, internal controls always imply a trade-off between the anticipated cost and benefit envisaged. (Is it worth to spend rupees ten thousand to prevent a possible loss of rupees five thousand?).

For example, those risks that have a low probability and low cost should simply be *ignored*. But for those with high probability and high costs, control activities need to be implemented to *prevent* the risk from occurring. For example, a disaster may have a low probability but it has a high cost, therefore management should employ *insurance and/or backup plan* as an appropriate control activity. This model requires management to identify what needs protecting, what the risks are for those assets, and the level of cost impact and probability for each risk. Therefore, the organization must do a comprehensive risk assessment before actually designing an internal control system, i.e., identify the risks to which it is subjected to and the corresponding amount of loss if that risk comes true. In other words, any Internal Control System must ensure that all anticipated risks are taken care up to the point of cost benefit analysis i.e., cost of effecting control or managing a risk does not exceed the estimated amount of losses, if that risk actually happens or comes true. However, this condition may not be strictly applicable to those controls, which are aimed at ensuring compliance with applicable laws and regulations.

The second ingredient or evaluation parameter is that of reasonable assurance. Even though in actual practice, there is no such thing as 'perfect internal control system'. No computer system is impervious to hacking attacks, malicious activities or sometimes genuine errors. Moreover as already stated above, controls have a cost and the concept of cost-benefit needs to be applied even to controls also. If it costs Rs. 2 crores per annum to make computer hacking free or error free and the risk assessment shows an estimated loss of Rs. 5 lakhs only, it may be better to have reasonable controls only to avoid prohibitive costs. Therefore, internal controls are designed to provide management with *reasonable assurance* regarding the achievement of these objectives.

It may be added here that most of the internal controls are aimed at anticipated risks or transactions of usual nature. Therefore, un-anticipated event or the transactions of un-usual nature may still escape all controls despite all precautions. Further, all controls need to be updated regularly to keep pace with changing conditions. So rigorous and effective internal controls of past may no longer be effective in present or future.

Lastly no depth of internal control can avoid losses due to potential human error or due to collusion between two or more persons. For example 'Disgruntled employees' probably present the highest risk—even more than hackers external to the firm. These people can always be motivated to cause harm to the organization and depending on their knowledge and access to systems, data or other assets, they can cause extensive damage. Similarly, a person



who has an extreme cash flow problem for any reason (like gambling, excessive lifestyle, etc.) may sometimes be tempted to steal assets to cover personal losses; often with the intention to "pay back" after some time. It is also sometimes possible that someone in the organisation may become an industrial spy.

Sometimes, *management* itself is a risky group. They can very easily override controls because of their unique position and hence can more easily commit fraud etc. Sometimes, managements are forced to do 'window dressing' of their balance sheets to show higher profits to contain the declining share prices or to earn their bonuses (if based on profits). Even the normal aggressive nature of managers can sometimes become a risk if not mitigated by strong personal and corporate ethics, and an effective internal control system (e.g., audit committee). For example, one management accountant reported his dilemma when his boss wanted him to reverse a correct accounting transaction because it resulted in the department missing its profit goals for the first time in three years. Such actions are indicative of ethical soft spots that can lead to fraud, theft, or material misstatements. These risks are very difficult to anticipate because of their nature. However this aspect should be thoroughly analyzed by external auditors during financial audits.

Therefore, an evaluation of internal controls is necessary to establish the effectiveness of those controls. The Auditor should keep in mind the following two sets of basic objectives while evaluating internal control –

- (a) to safeguard assets and control transactions; and
- (b) to provide reasonable assurance, through his opinion report' that there is no material errors in the financial statements.

10.5 EVALUATION OF INTERNAL CONTROL

The guiding factor for audit operations by the auditor depends to a great extent on the soundness or otherwise of the internal controls in the business. Due to the limitation of time, an auditor can spend limited time only on a company's audit. Therefore, he has to decide the extent of in-depth audit of many areas, particularly the checking and verification of routine aspects of financial transactions. Sub-para (iv) of para 4 read with para 3 of the Companies (Auditor's Report) Order, 2015 (CARO) requires that the auditor's report on the account of a company to which this Order applies shall inter-alia include a statement as to whether there is an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. It will also include whether there is a continuing failure to correct major weaknesses in internal control system.

The Board of directors of every listed company and the following classes of companies, as prescribed under Rule 6 of Companies (Meetings of Board and its powers) Rules, 2014 shall constitute an Audit Committee:

- (i) all public companies with a paid up capital of ₹10 Crores or more;
- (ii) all public companies having turnover of ₹100 Crores or more;
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding ₹50 Crores or more.

The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

Sub-section (5) of section 177 of the Companies Act, 2013 provides that the Audit Committee may call for the comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and the management of the company.

The Audit Committee shall have powers to investigate any activity within its terms of reference, to seek information from any employee, to obtain outside legal or other professional advice, to secure attendance of outsiders with relevant expertise, if it considers necessary.

The role of the Audit Committee to (i) evaluation of internal financial controls and risk management systems; (ii) reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems; (iii) reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit; (iv) discussion with internal auditors of any significant findings and follow up there on; (v) reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board; (vi) discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.

The Audit Committee shall mandatorily review the Internal audit reports relating to internal control weaknesses; and the appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee.

The evaluation of internal controls including internal accounting controls gives an opportunity to the auditor to a clearer insight into the operational systems and an overall view of the organizational workings to spot weaknesses in the systems and procedures both in respect of financial and operational areas of the business. The audit process effectively evaluates the auditee's existing internal controls through the use of questionnaires and flow charts. The internal control questionnaire is a list of systematically and logically prepared questions designed to find out and evaluate the effectiveness of internal control systems regarding various aspects and accounting transactions of an organization. The questionnaires are to be comprehensive in nature to ensure that all aspects and accounting transactions are covered which are to be replied by the officials of the department or division concerned. The criteria for replies against each question are "yes", "no", "not applicable", "explanatory notes" and comments". Normally the affirmative answers suggest satisfactory internal controls while negative answers suggest weaknesses of internal controls.

10.6 INTERNAL CONTROL QUESTIONNAIRE

While conducting audit, the statutory auditor will submit to the organization a complete questionnaire for reply by the relevant officials, which will help the former to form an opinion as to the adequacy and reasonableness of the internal systems. The statutory auditor may make do test checks or in-depth checking depending on the circumstances to make sure that the replies to the questionnaires are accurate and complete. In respect of many of the replies, the statutory auditor may have to make sure that the internal control systems are really in operation through proper verification. In respect of negative replies, he may have to qualify his audit report depending on the seriousness of the situation. In other words, the auditors will use sample testing techniques as a means of validations. Such sampling techniques will vary depending upon the internal control evaluation and results of prior tests. These techniques allow the auditors to review a limited number of transactions as a representative to the whole. In essence, the more testing required due to lack of internal control and lack of accuracy in the accounting records takes additional audit time therefore increases the cost of the audit also.



Internal Control Questionnaire regarding Purchases and Creditors:

Questions	Yes/No	Not Applicable	Comments regarding all negative answers and further information as to answer
Internal Control Questionnaire regarding Purchases and Creditors:			
(1) Whether Purchase Department is centrally responsible for all purchases?			
(2) Whether purchases are initiated only against the valid demands for procurements?			
(3) Whether the authorities competent for sanctioning of purchases have been clearly specified? Whether limits or ceilings have been prescribed within which purchases can be sanctioned by respective authority?			
(4) Whether a list of approved suppliers is maintained for each major item? Whether the list is updated regularly?			
(5) Whether there is competitive bidding for costly items or there is a list of approved short listed suppliers?			
(6) Whether deviations for procurement from other than approved short listed vendors permitted? If so, under what circumstances?			
(7) Whether any long-term purchase contracts have been entered into with the suppliers? Whether the stipulations regarding price, specification of goods, etc., in such contracts clear and unambiguous?			
(8) Whether cash purchases or other direct small purchases by production deptts. allowed. If so, under what circumstance?			
(9) Whether specific approvals required for the following : (a) Purchase from organizations in which managerial personnel are interested or stakeholders (related party transactions). Whether there is a system by which all managerial personnel up to a certain level are required to disclose their interest in various organizations? (b) High value purchases. (c) Long-term purchase contracts involving large amount in the long run.			
(10) Whether the same procedure followed in respect of purchase of both trading and capital goods?			
(11) How reasonability of prices is ensured especially in case of non-competitive biddings or emergency purchases or purchases involving small amounts? Whether the system is reasonable?.			

(12)	Where tenders/competitive quotations are invited, Whether it is ensured that no supplier gets an undue advantage? For example, What is the procedure for custody of sealed priced bids?, Whether sealed price bids opened transparently in presence of senior official and the representatives of the suppliers? If negotiations are conducted after the opening of the price bids, whether an equal opportunity given to all the short-listed suppliers or to the lowest quoted vendor only?			
(13)	Whether a record of the prices quoted by different suppliers maintained to serve as the basis for authorizing any purchase?			
(14)	Whether an item-wise (or code head wise) record of all the prices paid during previous procurements maintained?			
(15)	Whether a special approval necessary where any procurement is not based on the lowest price bid received?			
(16)	Whether the procurement prices are firm and fixed?			
(17)	Whether special authorization is required for insertion of price variance clause in a procurement contract?			
(18)	Whether purchase orders serial numbered?			
(19)	Whether unused blank purchase orders kept in proper custody?			
(20)	Whether purchase orders contain the following information:- (a) Serial Number (b) Name of supplier; (c) Quantity; (d) Detailed Technical Specifications (e) Price; (d) Terms of delivery; (e) Terms of transport; (f) Terms of payment; (g) Any other terms, such as packing, etc.			
(21)	Whether there are standard terms and conditions for all procurements			
(22)	Whether any variation from these standard terms and conditions need any special authorization?			
(23)	Whether the copies of the purchase orders are marked to the Accounts Department and the Goods Receipt Department?			
(24)	Whether the purchase department keeps a track record of pending purchase orders?			
(25)	Whether follow up action is taken with the user department w.r.t. pending Purchase Orders, so that the production schedule is not affected.			



(26)	Whether all goods and materials purchased are received by the Goods Receipt Department along with copy of invoice from Supplier (sometimes without price)?			
(27)	Whether the Goods Receipt Department physically counts, weighs or measures the goods received?			
(28)	Whether the Goods Received are also inspected w.r.t. their technical specifications?			
(29)	Whether the Goods Receipt Department prepares a Goods Received Note and Goods Inspection Note in respect of each consignment?			
(30)	Whether the copies of the Goods Received Note and Goods Inspection Note are marked to the Accounts Department, Purchase Department, Stores Department and the demand initiating department?			
(31)	Whether the Goods Received Notes are serial numbered?			
(32)	Whether the Goods Inspection Notes are serial numbered?			
(33)	Whether the Goods Receipt Department rejects the materials in case of shortage of quantity, defective goods or variations from specifications given in the purchase order? Whether whole consignment is rejected or defective goods only rejected.			
(34)	Whether in case of defective goods, an outward return note is prepared indicating the quantity and specifications of goods to be returned?			
(35)	Whether the goods returned promptly and an acknowledgement or return of goods obtained from the supplier? Where materials are accepted despite shortage or variations from specifications, whether these facts are mentioned on the challan sent to the supplier as well as on the goods received note?			
(36)	Whether the Accounts Department is informed about short-receipts or defective goods returned to the suppliers, so that Debit Notes maybe prepared in the name of the suppliers?			
(37)	Whether claims are filed with the insurers in case of goods lost or damaged in transit?			
(38)	Whether debit notes are serial numbered and the unused ones are kept in safe custody?			
(39)	Whether the invoices are received directly by the Accounts Department from suppliers?			
(40)	Whether each invoice received given a running serial number? Whether this serial number as marked on an invoice also marked on the supporting documents attached to the invoice such as purchase order, goods received note, etc.?			

(41)	Whether it is ensured that duplicate invoices are accepted only with proper authorization and only in such cases where the original invoices were not received? Whether duplicate invoices prominently marked 'duplicate' and attached with the supporting documents regarding the relevant purchase?			
(42)	Whether there are adequate precautions to prevent double payments against duplicate invoices?			
(43)	Whether there is a procedure for processing the invoices and credit notes along with check-list at each stage?			
(44)	Whether proper records are maintained to link the respective invoices with all advance payments and stage payments to suppliers?			
(45)	Whether the accounts department reconciles the quantity/value of goods received and as specified in the invoices and the stock records?			
(46)	Whether the Accounts Department keeps track of those Goods Received Notes or Goods Inspection Notes, where payment is pending for want of any reason including non-receipt of invoice despite satisfactory receipt of goods?			
(47)	Whether all invoices are entered promptly in the purchase book?			
(48)	Whether the first copy of all Goods Received Notes and Goods Inspection Notes is linked to respective invoices before the invoices are processed for payments?			
(49)	Whether the Accounts Department compares the quantities and value as shown in the suppliers' invoice with the Goods Received Note and the purchase order?			
(50)	Whether the goods received without corresponding invoices are accepted at the Goods Receipt Department? If yes, whether these are independently checked by persons other than those in Goods Receipt Department?			
(51)	Whether the invoices are finally cleared for payment only after linking with first copy of Goods Received Note, Goods Inspection Note and the relevant purchase order?			
(52)	Whether the Accounts Department reviews the accounts of vendors, who are both customer as well as suppliers to determine set-off of mutual claims?			
(53)	Whether the debit notes are serial-numbered? Whether the missing numbers duly enquired into?			
(54)	Whether there is a proper control over the issue of debt notes especially with regard to the competent authority to ensure their accuracy?			



(55)	Whether all debit notes are recorded promptly in the books of account?			
(56)	Whether there is a periodic review of the accounts statements received from suppliers' with the respective ledger accounts?			
(57)	Whether the differences between the statements received from suppliers' and their respective ledger accounts properly investigated and reconciled?			
(58)	Whether cash, cheques etc., are received only by persons authorized to do so?			
(59)	Whether there is a clear cut policy regarding granting of cash discounts and rebates, issue of credit notes, etc? Whether the officials, who are entitled to grant cash discounts / rebates are clearly specified in the policy along with the broad limits within which they can operate?			
(60)	Whether cash receipts are recorded in cash registers and serial numbered cash receipts issued?			
(61)	What are the controls over miscellaneous receipts like sale of scrap/waste etc.? Whether these transactions are executed under the supervision of a responsible officer?			
(62)	Whether cash receipts are issued in all cases of cash received, or receipts are issued only if so required by the party making the payment?			
(63)	Whether the cash receipts are pre-numbered?			
(64)	Whether sufficient controls are there to ensure that the details on counterfoils/copies of receipts are the same as those on the original receipts? (For example, use of receipts having automatic carbons whereby anything written on the original gets automatically transcribed on the copy or issue of cash receipt through the automatic cash register.)			
(65)	Whether all cash receipts are entered in the cash book on the same day? Whether the supervisor independently checks the cash book everyday to ensure up-to-date recording?			
(66)	Whether there is a system ensuring that all alterations in the copies/counterfoils of receipts, other documents, cash book and the ledger are made clearly, without overwriting and only under the initials of the supervisor?			
(67)	Whether a specific person is responsible for opening all the mails containing remittances. Whether he is required to prepare immediately a list of all cheques, drafts, etc., and mark them 'Account Payee Only'?			
(68)	Whether the customers and all other parties required or encouraged to make payment only through account payee cheques / drafts?			

(69)	Whether all cheques, drafts, cash etc., which are received up to a stipulated time during the day required to be deposited in the bank on the same day?			
(70)	Whether there is a system to ensure that cash, cheques, etc., collected by the authorized representatives of the enterprise (e.g. sales representatives) are recorded, deposited and reconciled promptly?			
(71)	Whether there is a system of sending periodic statements of account to customers and other parties from whom cash, cheques or drafts are received on a regular basis and requesting them to confirm the correctness of the statements?			
(72)	Whether there is a regular reconciliation of cash-in-hand as per the books of accounts and the physical balance in hand?			
(73)	Whether the counter-foils of the pay-in-slips used for deposits in bank are retained by the cashier?			
(74)	Whether there is a daily cross-checking between total receipts in cash or by cheques, and total credits to customers' accounts in the ledger?			
(75)	Whether all unused cash receipts books and cheques books kept in safe custody under the charge of a senior official and issued only after verifying that the previous cash receipt book / cheque book has been fully accounted for?			
(76)	Whether an internal audit of cash receipts conducted regularly? Whether surprise count of cash balance carried out periodically by the internal auditor or by another independent official, who does not have any duties relating to handling of cash or accounting for it?			
(77)	Whether the bank reconciliation statement is prepared periodically say every week to ensure proper reconciliation? Whether proper follow-up action is taken with regard to outstanding entries?			
(78)	Whether the balances in the Debtors' Accounts are periodically reviewed to keep them to minimum?			
(79)	Whether the old creditors' accounts, where payments are not being claimed by the suppliers are periodically reviewed to know the exact reasons?			



10.7 INTERNAL CONTROL AND INTERNAL AUDITOR

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) had recently issued the "COSO report", which was jointly sponsored by the Institute of Internal Auditors (IIA), the American Institute of CPAs, the Financial Executives Institute, the American Accounting Association, and the Institute of Management to provide a common, widely accepted definition of internal control and provide a framework of internal control which can be used as a benchmark for assessing its effectiveness. The COSO report defines internal control as follows:

...a process, effected by an entity's board of directors, management and other personnel, which is designed to provide reasonable assurance regarding the achievement of objectives in one or more categories:

- effectiveness and efficiency of operations
- reliability of financial information
- compliance with applicable laws and regulations

The COSO definition of internal control acknowledges that both management *and* non-management personnel play a significant role in making the internal control process function. The COSO study identifies five interrelated components of internal control:

- (a) the control environment;
- (b) risk assessment;
- (c) control activities;
- (d) information and communication;
- (e) monitoring.

The underlying foundation of internal control, termed as 'the control environment' is dependent on the people in an organization including their competence, attributes and their ethical values. The management must assess the anticipated risks (risk assessment) and devise mechanisms (control activities) to manage those risks to achieve its goals and objectives. Information and communication among people are vital links in the effective control system. Lastly, monitoring of internal controls is an ongoing process like managerial reviews or periodic reviews like internal self-assessment or an audit. The internal audit function is a part of internal control as part of the monitoring process.

Internal auditing has been defined as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. It is essentially a management control mechanism that operates through measurement and evaluation of effectiveness of other controls.

We know control compels events to conform to plans. Internal control is an essential part of control mechanism within an organization, which functions for the success of an organisation by way of implementation of organizational objectives, policies, plans and philosophy. To assess the effectiveness of internal control measures, it is essential to measure the extent of accomplishment of objectives through appraisal, review and evaluation of the related factors. Now, because appraisal, review and evaluation, in most of the organizations are done by the internal auditor through internal audit functioning, the importance of role of an internal auditor in the context of internal control cannot be exaggerated.

The importance of internal auditor in the field of internal control can also be brought about if reference is made to "Standards for professional practice of Internal audit" issued by the Institute of Internal Auditors Inc., USA, which *inter alia* include :

- (a) The purpose of the review of the systems of internal control is to ascertain whether the system established provides reasonable assurance that the organization's objectives and goals will be met efficiently and economically.

- (b) The purpose of the review for effectiveness of the system of internal control is to ascertain whether the system is functioning as intended.
- (c) The purpose of the review for quality of performance is to ascertain whether the organization's objectives and goals have been achieved.
- (d) The primary objectives of internal control are to ensure –
 - (i) reliability and integrity of information
 - (ii) compliance with policies, plans, procedures, laws and regulations.
 - (iii) the safeguarding of assets.
 - (iv) the economical and efficient use of resources.
 - (v) the accomplishment of established objectives and goals of operation or programmes.

As a matter of fact management is usually on the lookout for someone who can assure them that control systems implemented are being followed and periodically reviewed/cross checked for their suitability vis-à-vis adaptability to changing circumstances, so that management can earn confidence in managing the business in the desired direction. Then, the question arises as to the scope of appraisal by the internal auditor to aid management in keeping up confidence in running a business and in achieving organizational objectives. The internal auditor is to go beyond the ambit of control measures determined by appraising and assessing the extent of implementation of the management control systems, ensuring as well as assuring the management control systems are as effective as these are expected to be and thereby converting hopes and aspirations of the organization into reality and accomplishments.

Internal auditing, as has been seen, can therefore reveal a sound internal control system but nevertheless the support of the top and middle management is a must. Since control mechanism operates through men only, the human side of the enterprise is to be relied on for efficient control functions. Hence along with appraisal of control measures there has to be appraisal of performance of personnel.

10.8 ORIGIN OF INTERNAL AUDIT

The origin of internal audit goes back to thousands of years. There are records available, which show that the Greeks, Romans, and Egyptians were conducting audits before the birth of Christ. Interestingly, the scope of all these early audits was in many ways similar to that of modern internal audits. The audit in Government during the modern time dates back to the year 1789, when the first U.S. Congress approved an 'Act' that included a provision for the appointment of a secretary of the treasury, a comptroller, and an auditor. The auditor's job was to receive all public accounts, examine them, and certify the balances.

In the modern era, railroad companies in USA are often credited for being the first to introduce internal audit during the latter part of the nineteenth century. These railroad companies had *traveling auditors* to visit the railroads' ticket agents and determine that all the accounting for all monies was properly handled. Krupp Company in Germany had employed some type of internal audit staff at least as early as 1875, since there is an audit manual dated January 17, 1875, which inter-alia includes the following provisions:

The auditors are to determine whether laws, contracts, policies and procedures have been properly observed and if all business transactions were conducted in accordance with established policies and with success. In this connection, the auditors are to make suggestions for the improvement of existing facilities and procedures, criticisms of contracts with suggestions for improvement, etc.

The growth of large corporate houses during the early part of the twentieth century necessitated the need for extended span of control by the managements employing thousands of employees with manufacturing plants at many locations and sales & marketing all around the world. The traditional form of audit by the public accountant was not very effective in these companies because of huge distances between different locations besides being proving very costly also as it necessitated lot of traveling. Therefore, a need was felt for internal auditors at all the



locations mainly for protection of assets. The objectives of internal audit during this period have been explained as under:

Protection of company assets and detection of fraud were the principal objectives. Consequently, the auditors concentrated most of their attention on examinations of financial records and on the verification of assets that were most easily misappropriated. A popular idea among management people a generation ago was that the main purpose of an auditing program was to serve as a psychological deterrent against wrongdoing by other employees.

However, this role of internal auditor has undergone a vast change during the second half of twenty first century. Earlier, internal auditing was essentially to check the records after those had been created to ensure accuracy. These internal auditors were also concerned with the possibility of fraud. Thus, the main role of internal auditor was that of a verifier, or a "police-man," or a "detective" to protect the companies' assets.

The emergence of war economy during 1940s is attributed credit for the initial expansion in scope of internal audit. With huge back-log of orders, managements became more concerned with production scheduling, shortages of materials and labourers, and compliance with regulations. Most of these contracts were on cost plus basis. Therefore, cost reporting also became more important. As a result, internal auditors began directing their efforts towards other areas also, which were till then outside the purview of internal audit.

The fast technological leaps and global expansion are also responsible for the fast changing and ever expanding role of internal auditors. With emergence of very powerful and cheap computers, accounting has become mechanized and computerized. These are subject to automatic checking procedures. Thus, there may no longer be the need to check each and every transaction. Therefore, the modern concept is that internal auditors are an arm of the management and are just as concerned with waste and inefficiency as with fraud.

Arthur H. Kent's published an article, "Audits of Operations," in March 1948 describing the expanded-scope of audit. Kent made frequent mention of an *operations audit* in that article. However, by the 1970s, the paradigm shift in the role of internal auditors from financial perspective only to wide operational perspective had become profound and permanent. The modern work of the internal auditor had become more of auditing for efficiency and effectiveness than financial propriety. Thus, the main objective of the Internal Audit function has shifted from fraud detection to assisting managements in making decisions. This has also ensured that the internal auditor was now an important integral part of the management team.

10.2.8 Section 301 (Public Company Audit Committee) of the Sarbanes-Oxley Act passed by the U.S. Congress in the year 2002 requires an audit committee in all the listed companies. Section 404 (Management Assessment of Internal Controls) of the said Act requires an annual report on management of the internal controls and their effectiveness. The law requires annual reports to contain an assessment of the effectiveness of internal control over financial reporting. In addition, it also requires the adoption of standards for independent auditors to attest to management's report on internal control. Separately, the act requires a company's CEO and CFO to certify quarterly and annual reports. These developments will ensure the necessity for the adequate and effective internal audit department in all the listed companies to assist management with these requirements. Similar provisions are already in place under the Indian Companies Act, 2013.

10.9 INTERNAL CHECK AND INTERNAL AUDIT

As already explained above, internal check and internal audit are important ingredients of any system of internal control. Internal check is a system of instituting 'checking' on the day-to-day transactions as part of the routine system, whereby the work of one person is proved independently or is complementary to the work of another person i.e., the prevention and early detection of errors or fraud. Therefore, the systems are so designed that no single individual is responsible for all the stages involved in a transaction i.e., duties are allocated in such a way that no single individual has an exclusive control over any one transaction or a group of transactions. Thus, making it difficult for a fraud to take place unless there is a collusion between two or more persons. In addition to the complementary allocation of duties, an internal check system also involves prompt and independent validation of an individual's work by including cross-checks and cross-reconciliations as a part of the operating procedure itself. For example, in case of banks, there are always two or more persons involved in payment of cash withdrawal against cheques.

One bank employee will receive the cheques, issues token against it, checks the balance amount available in the account and makes the necessary entry in the ledger. The supervisor then authorizes the payment to be made by the cashier after verifying the signatures etc. Thus, the responsibilities in any bank are always divided in such a way that that no one person can authorize, execute, and record the transaction.

Internal auditing, on the other hand is "an independent appraisal function established within an organisation to examine and evaluate its activities as a service to the organisation. The objective of internal auditing is to assist members of the organisation in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed." The scope of internal audit is by definition determined by the management. For example, one organisation may have very narrow scope of internal audit concerning itself mainly with the routine checking of accounting transactions on a daily basis, whereas the scope of internal audit in another enterprise may be wide enough to include reviewing the efficiency and effectiveness of each department of an organisation.

It can, thus, be concluded that the term internal control has its all-embracing nature and is concerned with the controls operative in every area of corporate activity as well as with the way in which individual controls interrelate. Therefore, internal check and internal audit are two important ingredients of internal control. Internal checks are procedures inbuilt in the overall system itself and take place concurrently with the execution of the transactions, whereas internal audit is a distinct function which is carried out after the transactions have taken place.

10.10 INTERNAL AUDIT AND ITS SCOPE

Internal auditing is an independent appraisal activity within an organization for the review of operations as a service to management. It improves managerial control by measuring and evaluating the effectiveness of other controls, and by maintaining a vigilant watch over risks.

It comprises a complete intra-company financial and operational review, which is undertaken within an organisation by specifically assigned staff. The usual meaning attached to the concept of internal audit are as follows :-

- (a) Internal audit is a continuous and a systematic process of examining and reporting the operations and records of a concern by its employees, or external agencies specially assigned for this purpose. It is, in essence, auditing for the management and its scope may vary, depending upon the nature and size of the concern.
- (b) H. Wasbrook in his book, "The Board and Management Auditing" has defined internal audit as "in its narrow sense, such an audit is one that is carried out by the specialist staff of the organisation being audited, it concerns itself mainly with the routine checking of (usually) accounting transactions on a daily basis, with the object of quickly locating irregularities, thus making it more difficult to perpetrate a fraud, because of the constant nature of the checking".
- (c) Internal audit is a management tool, performed by employees of the organisation to ensure correctness in accounting data and to detect fraud by way of periodical review of organizational systems and procedures.

This definition is also quite clear in explaining the term and has laid emphasis upon "independent appraisal" of the related individuals in the organisation and is not mainly with the routine checking. This requires the internal auditor to go beyond the records in the books and to review and report the performance in the area of finance, accounting and other related operations.

Internal audit is in fact a control system that functions through examination and appraisal of other control mechanisms operating within the organisation. It keeps close eyes on the business to ensure that all transactions are duly recorded in complete form and that faulty, inefficient or fraudulent operations are revealed and corrected. It provides a proper foundation where all assets get properly protected and the structure for better operations and higher profitability is embodied.

According to the Institute of Internal Auditors, internal audit involves five areas of operations:

1. *Reliability and integrity of financial and operating information:* Internal auditors should review the reliability and integrity of financial and operating information and the means used to identify, measure, classify and report such information.



2. *Compliance with laws, policies, plans, procedures and regulations:* Internal auditor should review the systems established to ensure compliance with those policies, plan and procedures, law and regulations which could have a significant impact on operations and reports and should determine whether the organisation is in compliance thereof.
3. *Safeguarding of Assets:* Internal auditors should verify the existence of assets and should review the means of safeguarding assets.
4. *Economic and efficient use of resources:* Internal auditor should ensure the economic and efficient use of resources available.
5. *Accomplishing of established objectives and goals for operations:* Internal auditor should review operation or programmes to ascertain whether results are consistent with established objectives and goals and whether the operations or programmes are being carried out as planned.

It is said that scope of internal audit is very much related to business phases. The first phase of business is basically the planning stage, and the decisions are on issues like whether to make or buy, whether to undertake a new project or export etc. These are more of managerial decisions and the scope of internal audit is often not much practical, in the initial stage, unless it takes to what is called management audit. The 2nd phase is the execution stage having its base in the subsequent recording in the books of account. In this stage, the scope of internal audit emerges out of need for correctness of accounts and proper classification of heads in a required manner. The third and final phase is the review of transactions where scope of internal auditing is immense. This internal auditing is a function distinct from authorization and recording, which concerns not only with examination of the transactions as recorded in the books of account, but also the appraisal of the procedures with a view to affecting change for better efficiency, as far as practicable. For a better understanding of nature and scope vis-à-vis objectives of internal audit, the following may be of interest:-

- I *Independent* appraisal, review and evaluation
- N *Necessity* of specialist service
- T *Thorough* in making study
- E *Ensure* complete objectivity
- R *Reporting* without fear or favour
- N *Narrow* down the gap between management objectives and the efficiency achieved.
- A *Assure* better management
- L *Look* for all round efficiency
- A *Aid* to management
- U *Understanding* operational and management auditing
- D *Discuss* to find out acceptable solution
- I *Improving* internal control
- T *Test* for efficiency and effectiveness

A proper organisation structure for internal auditing department ensures its relative independence so that it can carry out its work freely and objectively and render impartial and unbiased decision. The institute of Internal Auditors has stated that "organizational status of the internal auditing department should be sufficient to permit the accomplishment of the audit responsibilities". So to ensure this the management and the Board of Directors must give full support to the internal auditors. The functions, responsibility and authority of the internal auditing department should be clearly and specifically laid down in a written document. The chief internal auditor should have direct communication with the Board of Directors. He should submit periodic reports to be the Board highlighting significant audit findings.

10.11 STATUTORY AUDITORS AND INTERNAL AUDITORS

In view of the similarity between much of the work of internal and external auditors, it is appropriate to consider the fundamental difference between these two. The objective of internal auditing is mainly to assist the organization in the effective discharge of responsibilities by furnishing them with analyses, appraisals, and recommendations concerning all the activities reviewed. The internal auditor is concerned with every phase of business activity where he may provide service to the organization. This scope goes beyond the accounting and financial records to obtain the full understanding of the operations of the organisation. The attainment of this overall objective inter-alia includes the following activities:

- Reviewing and appraising the correctness and adequacy of accounting, financial, and other operating controls ensuring effective internal control at optimum cost;
- Validation to ensure the compliance with established policies, plans, procedures and applicable laws and regulations;
- Accounting and safeguarding the assets of the company from losses of all kinds;
- Validation to ensure the reliability of management data developed within the organization;
- Validating the quality of performance in carrying out assigned responsibilities; and
- Recommending operational improvements and corrective measures.

The external auditor, on the other hand has a statutory responsibility to report on the true and fair view of the accounts of the company and whether proper books of accounts and other accounting record have been kept. These responsibilities cannot be delegated to others. However, the objectives and scope of the internal audit on the other hand are determined by management. It is actually a managerial control which functions within the scope determined by the management.

The external auditor is appointed by the shareholders of the company in the annual general meeting in accordance with the provisions of the relevant Companies Act and is therefore accountable to them. The internal auditor is appointed by the management and is, therefore responsible to the management. The exact role and scope of internal audit shall vary from company to company, whereas the ultimate objective of statutory audit is same in all the companies.

The qualifications of the statutory auditors are prescribed under the provisions of section 148 of the Companies Act. However, there are no minimum qualifications prescribed under the companies act for the persons appointed to act as internal auditors. Similarly, section 143 of the Companies Act allows to the statutory auditor, the right of access at all times to the books and accounts and vouchers of the company, whether kept at the head office of the company or elsewhere. Statutory auditor is also entitled to require such information and explanation as he may think necessary for the performance of his duties as statutory auditor. However, there are no such rights available to the internal auditor.

In other words, the internal audit is an internal control from the point of view of statutory auditor, which functions by appraising and evaluating other controls. The statutory auditor evaluates the extent of the scope of the internal audit and takes this into account in determining the exact scope of his own work.

10.12 ASSESSMENT OF ADEQUACY OF INTERNAL AUDIT FUNCTION

Sometimes it is required to assess the adequacy of internal audit function of an organisation. The following questionnaire will enable to evaluate the work of the internal auditor and assess the adequacy of the internal audit function:

1. What is the organizational set up of the department?
2. Is the staff employed in the department adequate?
3. Are the qualifications of the staff adequate?



4. Is the staff competent?
5. Is the staff independent?
6. To whom do they report frequently and with what effect?
7. Is there any internal audit manual?
8. Is a programme of internal audit drawn up before the commencement of the financial year?
9. Does the programme cover the audit of all the important transactions and records of the company including statutory cost accounting records?
10. Is the scope of internal audit wide enough to extend to areas such as, management audit, operational audit and system analysis?
11. What is the system of reporting irregularities noticed during internal audit?
12. Is prompt corrective action taken by the management on the basis of internal audit reports?
13. Is there much duplication of work between the statutory audit and internal audit?

10.13 AUDITING GOVERNMENT AGENCIES

Various governmental audit agencies throughout the world have played a role in the movement toward the modernization of internal audit procedures. In the United States, the General Accounting Office (GAO) has played a major part in broadening the role of the auditor. The GAO's publication, *Standards for Audit of Governmental Organizations, Programs, Activities and Functions* (commonly called the "Yellow Book" because of the color of its cover) explains the metamorphosis in the following manner:

- *This demand for information has widened the scope of governmental auditing so that such auditing no longer is a function concerned primarily with financial operations. Instead, governmental auditing now is also concerned with whether governmental organizations are achieving the purposes for which programs are authorized and funds are made available, are doing so economically and efficiently, and are complying with applicable laws and regulations.*

Basically, the recommended standards encompass those standards that have been adopted by the AICPA for use in audits to express an opinion on the fairness of financial statements. Governmental audits, however, go a step beyond those standards that are applicable to audits of financial statements. The scope of a governmental audit (e.g., an audit of or for a government agency) is composed of three elements:

1. Financial compliance,
2. Economy and efficiency, and
3. Program results.

The typical definition of a financial audit would not include elements 2 and 3. These are operational auditing techniques.

10.14 PROVISIONS OF INTERNAL AUDIT UNDER COMPANIES ACT 2013

Section 138 of the Companies Act 2013 deals with provisions of Internal Audit.

As per section 138,

- (1) Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a **cost accountant**, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.
- (2) The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

Rule 13 - Companies(Accounts) Rules, 2014 states that:

- (1) The following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely:-
- (a) every listed company;
 - (b) every unlisted public company having-
 - (i) paid up share wealth of fifty crore rupees or more during the preceding financial year; or
 - (ii) turnover of two hundred crore rupees or more during the preceding financial year; or
 - (iii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
 - (iv) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and
 - (c) every private company having-
 - (i) turnover of two hundred crore rupees or more during the preceding financial year; or
 - (ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

Provided that an existing company covered under any of the above criteria shall comply with the requirements of section 138 and this rule within six months of commencement of such section.

10.15 QUALITIES OF GOOD INTERNAL AUDITOR

Qualities of good Internal Auditor

According to 'Technical Guide on Internal Auditing' by The Institute of Cost Accountants of India, Internal Auditor should have following three traits:

- Technical Expertise
- Right Attitude
- Communication and other soft skills.

An Internal Audit team has to have representation from diverse professional fields in order to understand the organization better, audit its function better and making internal audit recommendation better. Carrying 'right attitude' is most sought after skill of Internal auditor. Communication skills of Internal Auditor should be so strong to fit him in different roles while providing suggestion and consultancy to the Audit Committee, top Management and Auditees. Other soft skills include optimistic mindset, emotion regulation and presentation skills.

10.16 INTERNAL AUDIT – INDIA

- (i) Clause 49 of Listing Agreement - Responsibility of audit committee to review adequacy of internal audit function and internal audit reports.
- (ii) The Board of directors of every listed company and the following classes of companies, as prescribed under Rule 6 of Companies (Meetings of Board and its powers) Rules, 2014 shall constitute an Audit Committee:
 - (a) all public companies with a paid up capital of ₹10 Crores or more;
 - (b) all public companies having turnover of ₹100 Crores or more;
 - (c) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding ₹50 Crores or more.

The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.



- (iii) Companies (Auditor' s Report) Order, 2015 - The Central Government, in terms of the power vested under Section 143(11) of the Companies Act, 2013 had notified the Companies (Auditor' s Report) Order, 2015. Clause (iv) of CARO, 2015 requires the auditor to report as follows: is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system.
- (iv) The Securities and Exchange Board of India has mandated complete internal audit on a half-yearly basis for stock brokers/trading members/clearing members.
- (v) IRDA (Investment) (Fourth Amendment) Regulations, 2008 has introduced requirements of quarterly internal audit for insurers.
- (vi) Companies going in for tapping the international capital market, especially, those seeking listing in US stock exchanges, NASDAQ, NYSE, etc., also need a strong internal audit function to meet the stringent corporate governance and internal control requirements of those stock exchanges. In this context, the US companies, having US public as investor also needs to comply with the requirements of Sections 302 and 404 of the Sarbanes Oxley Act of 2002.

10.17 OPERATIONAL AUDIT

The internal audit function in any organisation can be broadly categorized into three major functions namely (a) financial audit (b) compliance audit and (c) operational audits. However, an operational audit is sometimes defined as an extension of a financial audit. Regulatory agencies or other organizations concerned with compliance generally either send in their own auditors or hire an external audit firm. Therefore, Internal Audit mainly plays a supplementary role only in financial and compliance audits, but operational auditing is the primary, albeit not the exclusive, domain of the internal auditor.

An operational audit (or value-for-money audit) has been defined as an organized search for ways of improving efficiency and effectiveness. The objective is to assist the organization in performing functions more effectively and economically with focus on the efficiency and effectiveness of operations, it is also stated to be an early warning system for the detection of potentially destructive problems.

An operational audit can lead to better management of all aspects of business organisation whether it is production area or service area. Traditionally, operational audits have been conducted by means of a questionnaire interview of departmental employees. Virtually all large companies conduct operational audits in their major production and service departments. The financial audit tells where the entity was and where it is on the date of the balance-sheet. However, an operational audit tends to answer the questions as to why the entity is where it is and how it got there. It means the evaluation of management's performance and efficiency. Therefore, Operations Audit is a process to determine ways to improve production. It falls into the category of a management service by evaluating the four functions of management: (1) planning, (2) organizing, (3) directing, and (4) controlling. The operational audit can also be broken down further as a functional review; for example, Purchasing as a department versus the overall Procurement operation in coordination with production scheduling and market forecasting. The following table highlights the salient features of the traditional form of internal audit and operational audit :

INTERNAL AUDIT	OPERATIONAL AUDIT
1. Compliance objective	Risk identification, process improvement objective
2. Financial accounts focus	Business focus
3. Audit focus	Efficiency & improvement focus
4. Transaction-based	Process-based
5. Policies and procedures focus	Risk management focus
6. Cost Centre wise budget monitoring	Accountability for performance improvement results
7. Methodology : Focus on policies, transactions and compliance	Methodology : Focus on goals, strategies and risk management processes

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) had recently issued the "COSO report", which was jointly sponsored by the Institute of Internal Auditors (IIA), the American Institute of CPAs, the Financial Executives Institute, the American Accounting Association, and the Institute of Management to provide a common, widely accepted definition of internal control and provide a framework of internal control which can be used as a benchmark for assessing its effectiveness. The COSO report defines internal control as follows:

...a process, effected by an entity's board of directors, management and other personnel, which is designed to provide reasonable assurance regarding the achievement of objectives in one or more categories:

- effectiveness and efficiency of operations
- reliability of financial information
- compliance with applicable laws and regulations

Operational audits concerned with the objectives of efficiency and effectiveness. There are many reasons for performing an operational audit: compliance with policies and procedures, excessive sales returns, proposed product mix, equipment down time or personnel turnover etc. Therefore, an auditor must establish the scope of an operational audit before formulating the approach to initiate an operational audit. This step will determine the extent of the scope of audit. The second step shall be to understand the auditee's operation, its purpose in the total environment of the entity, its history, its image, its staff, their skills and competence and its reporting path. The reporting path is of very critical importance because this path is the communication route along which, the audit results and conclusions will flow.

The prime records to be obtained in an operational audit are the organizational chart of the function/operation, applicable policies, guidelines and procedures etc. These will outline each employee's responsibility and authority. The function's/operation's performance reports for the reasonable period prior to the audit should be reviewed to do trend analyses or the critical analyses. These analyses or reports could indicate potential critical areas such as over- or under-staffing, noncompliance with corporate policies and procedures, weaknesses in internal controls, or inadequate job rotations etc. These indications could help the management auditor in determining scope of investigation and areas of potential improvement. Reports must be based on facts, informative, submitted in time and directed to the proper levels of management.

10.18 BUDGETARY CONTROL SYSTEM

Budget and Budgetary Control – Nature and Scope

A budget is a financial and/or quantitative statement prepared and approved prior to a period of time, to the policy to be pursued during that period for the purpose of attaining a given objective.

Budgetary control is the establishment of budget relating to the responsibilities of executives to the requirements of policy, and the continuous comparison of actual with budgeted results either to secure by individual action the objective of that policy or to provide a basis for its revision (CIMA). Budgetary control is not a type of costing but is extensively used in all types of industries, businesses, Government departments as a system of control through responsible persons – such as executives, departmental heads, foremen, supervisors, etc. The main steps under budgetary control are as follows –

- (1) Establishment budgets for each section of the organization and incorporating the functional budgets in summary or master budget consisting of a forecast or budgeted profit and loss account and balance sheet;
- (2) Recording of actual performances and continuous comparison of the actual performances with that of the budget so as to determine the variances from the budget; and
- (3) Ascertainment of reasons for such variances and taking suitable actions to remedy the defects in order to achieve the objective under original policy or to provide a basis for its revision wherever necessary.

Budgetary control is designed to assist management in the allocation of responsibility and authority, to aid in making estimates and plans for the future, to assist in the analysis of the variation between estimated and actual results, and to develop bases of measurement or standards with which to evaluate the efficiency of operations. The



objectives and consequently the advantages of budgetary control will be felt throughout the whole organization, as a sound system of budgetary control –

- (1) combines the ideas of different levels of management in the preparation of the budget;
- (2) coordinates all the activities of business in order to centralize control but decentralize responsibility onto each manager involved;
- (3) plans and controls income and expenditure so as to achieve the highest profitability acts as a guide for management decisions;
- (4) ensures sufficient working capital and other resources for the efficient operation of the business;
- (5) directs capital expenditure in the most profitable direction;
- (6) reduces wastes and losses to minimum and thus ensures an increase in productivity as regards men, machines and materials;
- (7) provides a yardstick against which actual results can be compared; and
- (8) shows management where effort is needed to remedy the situation without any delay.

In order that a budgetary control is operated effectively, there must be an efficient organisation for budgetary control. The budgetary control organisation is responsible to the chief executive of a business. An advantage to this system is that decisions can be taken at the highest level where there is a conflict between the aims of the managers of two or more divisions. Moreover, where budgetary control has the support of the chief executive, those executives or managers who are responsible to him will fully cooperate and place more reliance on budgetary control. While the chief executive bears the responsibility for the effectiveness of the budget, the detailed preparation and administration of budgetary control is always delegated to subordinates as a functional responsibility and particularly to the budget committee with the budget officer as a secretary to the budget committee.

The different types of budgets are – (1) Functional budgets and (2) Master budget. The master budget summarises all the functional budgets in the form of budgeted profit and loss account and the budgeted balance sheet. Such master budget shows the target profit to be achieved by the organisation as its main objective.

ADEQUACY OF BUDGETARY CONTROL SYSTEM

While determining the adequacy or otherwise of the budgetary control system of an organisation, it is essential that management auditor should evaluate its coverage and effectiveness i.e., whether the system in operation covers all functions rather than an accounting exercise. For this purpose, he should examine whether the system contributes towards accomplishing the basic task of planning, coordinating and controlling the activities of the organisation in relation to the product under management audit. The management auditor should examine and appraise the following points :-

(a) In the area of planning:

1. Where it covers all interrelated functions like production, sales, purchasing and finance.
2. Whether it determines the linkage between budget centres and responsibility centres.
3. Whether it establishes definite goals and limits for these functions well in advance. The system must answer the questions such as “what they are expected to operate?” What will be the financial requirement for the functional areas? What would be the potential problems in the key areas?
4. Whether there are imbalances in the fixation of performance levels of functional budgets in relation to sales budgets.
5. Whether budget monitoring cell exists for operating the system in right perspective.

(b) In the area of coordination :

1. Whether the budget monitoring committee holds its meeting regularly with a view to ensure performance evaluation.

2. Whether it helps to prevent waste that results in duplicate or cross purpose activities.
 3. Whether it reveals timelines in the process of preparation and approval of all functional budgets and master budget.
- (c) In the area of control :
1. Whether system exists for measuring, comparing and quantifying the results of all functional areas.
 2. Whether the budget incorporates a degree of flexibility with a provision of its periodical review.
 3. Whether the variance reports are issued in time and appropriate corrective action is taken on these variances.

10.19 CAPACITY UTILISATION

Need for Capacity Determination

The need for determining "production capacity" in respect of industrial organisation in India arises from the following reasons :-

- (i) To meet the requirement under Section 129 of the Companies Act, 2013, that prescribes the form and contents of the balance sheet as well as profit and loss account (Schedule III of the Companies Act).
- (ii) For purpose of Cost Audit Report under section 148 of the Companies Act, 2013 where a cost audit has been ordered by Government.
- (iii) For internal management purpose, to be used:
 - (a) in planning, scheduling and controlling production, and
 - (b) in planning expansion of capacity and correction of imbalances.
- (iv) For assessment of capacities for national level planning.
- (v) For fixing the price of product(s) after ascertaining the capacity costs and per unit incidence thereof, and
- (vi) For determination of allotment of scarce raw-materials in the form of quotas, import licenses, etc.

Adequacy of Capacity Determination and Utilisation Mechanism

Capacity can be defined as the rate of output at which there is no incentive to alter the size of the plant if the rate of output is expected to be permanent. The management auditor is required to give his suggestions on rectification of general imbalance in production facilities under Para 14 of the Annexure to the Cost Audit Report. He is also required to give his suggestions for improvement in capacity utilization. Capacity planning and production planning and control are the prerequisites to capacity utilization control mechanism. For capacity planning, he must consider such factors as –

- (a) level of capacity planned and operated by the company,
- (b) whether the capacity is expressed in machine hours, labour hours or a combination of both,
- (c) whether capacity is planned on single, double or triple shift basis,
- (d) whether capacity is planned at normal production level or at practical production level,
- (e) key areas of production constraints in capacity achievement.

The management auditor shall consider the following points in the evaluation and measurement of capacity utilization –

1. Method of measuring base machine capacity.
2. Clear guidelines should be available regarding assessment of capacity. Technical terminology like licensed capacity, installed capacity, rated capacity etc. should be properly defined.



3. In some industries capacity is influenced by a number of factors and determining the single base figures requires adjustment of various variables such as volume of vessels, yield of product, recovery factor, cycle time etc.
4. Whether the system provides for comparative studies such as :
 - (i) Rated output and actual output per unit of time.
 - (ii) Normal output and actual output per unit of time.
5. Determine whether the capacity utilization report is being compiled by a person not responsible for production.
6. Whether capacity measurement is based on "capital output ratio" or sundry other factors.

$$\text{Estimation of capacity} = \frac{\text{Real fixed capital}}{\text{Minimum capital output ratio}^*}$$

* Capital /Real output

$$\text{Capacity utilization} = \frac{\text{Real fixed capital}}{\text{Minimum Capital Output Ratio}} \times 100$$

ICWAI has issued COST ACCOUNTING STANDARD 2 (CAS 2) regarding 'CAPACITY DETERMINATION'. The object of CAS 2 as stated in chapter 4 is to prescribe the method of determination of capacity to be applied uniformly and consistently. The standard will also help the management to identify the bottlenecks, imbalances and idle capacity for effective use of various resources. The standard has been recommended to be followed for capacity determination required to be carried out for any purpose or under provisions of any Act, Rules or Regulations except where capacity determination has been prescribed otherwise. The standard is applicable for an undertaking, whether existing or new, where there is expansion of more than 5% of the existing capacity due to introduction of new machines or productive resources. Similarly, the standard is also applicable where there is more than 5% reduction of the existing capacity due to disposal or withdrawal or impairment of old machines or productive resources. In other words, whenever more than 5% variation in capacity (whether positive or negative) takes place in any of the units covered under Companies (Cost Records and Audit) Rules, 2014 the Cost Auditor is required to undertake the capacity determination under these rules as per this standard.

The Cost Accounting Standard explains the detailed methodology to determine 'installed capacity' in para 5, 'practical / achievable capacity' in para 6 and 'normal capacity' in para 7 of the standard. In view of above, it is imperative that the management auditor should determine the capacity as per the said CAS 2.

Suggestions to Rectify Imbalance in Production Facilities

Imbalance in production facilities is resulted when the capacities of different equipments of a plant does not match. One type of equipment is capable of producing more than the receiving equipments. As a cost auditor following suggestions can be made to rectify such imbalance :-

1. The measurement must opt for "sub-contracting" outside the firm that part of the job which is restricting the production.
2. Install balancing equipment with higher output potential.
3. Introduce shift working among the operatives.
4. If there is consistent imbalance in the production facilities, entire plant can be replaced by installing new automatic plant.
5. Idle equipments can be sold so that entire attention can be diverted to the critical equipments.

10.20 INVENTORY CONTROL

Introduction

The term "inventory" includes all idle resources kept in stock for business purpose. Thus it includes mainly stock of raw materials, work-in-progress and finished goods, stores and spare parts, etc. Inventory control is possible with the help of Perpetual Inventory System along with continuous stock taking. The following aspects may be taken into consideration for proper inventory control –

1. Maximum, minimum and reorder level fixation
2. Fixed order quantity system and different replenishment systems.
3. ABC method
4. Pareto distribution
5. VED analysis
6. Just-in time (JIT) purchasing
7. Fast moving, slow moving and non-moving analysis.

The cost auditor can get an idea about the internal control relating to inventory from the following questionnaire.

Internal Control Questionnaire Relating to Inventory

1. Is the storage accommodation adequate to provide production against
 - Deterioration?
 - Access by unauthorized persons?
 - Any other local hazards?
2. Are issues from stores made only on properly authorized requisition?
3. Who are authorized to sign requisition? Specify name, position etc.
4. Are bin cards or similar records maintained at stores location?
5. Are continuous stock records maintained for
 - raw materials?
 - bought out components?
 - consumable stores?
 - finished goods?
 - stocks held on behalf of third parties?
6. Are these records maintained
 - in quantity only?
 - In value only?
 - In both quantity and value?
7. Are stores record maintained by a person independent of
 - The stores keepers?
 - Those responsible for physically counting or checking stocks?
8. Are independently maintained control accounts kept for each category of stock set out in 5?



9. Is the counting system fully integrated with the financial records?
10. If not, are totals of various categories of costs (including overheads) regularly reconciled with the actual costs in the financial records?
11. Are works orders issued
 - against specific orders?
 - on the basis of predetermined production targets?
 - on some other basis. (describe)
12. How are works orders authorized? Specify:
13. On what basis are materials, labour and other direct costs charged to work-in-progress accounts? Specify.
14. Are overheads clearly divided into fixed and variable overheads?
15. What is the basis of allocation of overheads to costs and what overheads are recovered in this way? Specify:
16. Does the system ensure that excess or abortive costs are written off and not carried forward in work-in-progress?

10.21 MANAGEMENT INFORMATION SYSTEM

Introduction

Management information system or MIS is an information system making use of available resources to provide managers at all levels in all functions with the information from all relevant sources to enable them to make timely and effective decisions for planning, directing and controlling the activities for which they are responsible.

Management information is an essential management tool. MIS provides for the identification of relevant information needs the collection of relevant information, processing of the same to become usable by the business managers, and timely dissemination of processed information to the users of the information for properly managing the affairs of an enterprise by informed decisions. The design of MIS reflects not only a rational approach for optimization of benefits but takes due note of behavioural impacts on organizational decision-making.

The introduction of computers as a means of processing data to produce management information has made it possible to consider sophisticated management information system.

On account of enormous technological advances in computer engineering in data capture, storage, processing and transmission, it is now practicable in most cases to record and store all the information generated by any operation or decision within an organisation in one mammoth set of storage files. The comprehensive data stored in this way will then be available to provide management with any information which may be required in the future to deal with any problem. With the introduction of LAN (Local Area Network) and WAN (Wide Area Network) and INTERNET, to day it is possible to obtain data through computers from one place although the manufacturing units are situated at different parts of the country.

Using the computer for audition there is no doubt that computer obviates several intermediate printouts and the hidden records in the magnetic media could be problems for the auditor not adequately trained in computer data processing, but the very facts that records are in a machine readable form suggests possibility for using the capabilities of the computer to assist the auditor in his burdensome task. This however requires that the cost auditor is sufficiently proficient in computer data processing and programming. Where the control in both data processing and user's department is adequately reliable. The stipulations of an audit may be dropped, and instead the cost auditor may comply special technique.

Management Information System and Cost Auditor

The cost auditor has to consider various aspects while evaluating the effectiveness of a Management Information System. At first he should consider the following aspects while appraising the MIS –

- (i) the content, quality and source of information.

- (ii) flow of information from the originator to the receiver, and
- (iii) correlation of information in the decisional areas.

Contents and sources of information : This may include the following :

- (i) Whether the information collected is relevant to the decision problem or whether it will result in the improvement in the quality of decisions.
- (ii) Whether there is any tendency of the manager to use control data for postmortem exercise
- (iii) Whether the reporting of MIS is regular and uniform for financial and non-financial information.
- (iv) Whether the information contain unwanted information.
- (v) Whether the MIS adequately caters to the requirements of decision makers.

Flow of information : A cost auditor has to proceed on the following lines :

- (i) System organisation :
 - (a) system is centralized or decentralized,
 - (a) flow of information from various units to the control section,
 - (b) estimating the volume of data, transmission time and cost,
 - (c) cost-benefit analysis of centralized v. decentralized information.
- (iii) *Data collection and management* : Appraisal should include the following aspects:
 - (a) methodology of collecting data,
 - (b) whether the data is filtered and classified,
 - (c) whether the data is properly matched with decision problems,
 - (d) whether the management carried out detailed study regarding existing frequency,
 - (e) whether system design is free or any possible constraints.

Correlation of MIS with the decision areas : Cost auditor should examine this aspect from the following angles:

- (i) Whether input-output analysis is attempted.
- (ii) Whether MIS is helpful in reducing the effects of uncertainty.
- (iii) Whether MIS is cost-effective.
- (iv) Whether the information is being supplied to the users very effectively.
- (v) Whether MIS is providing a feedback for corrective action, and
- (vi) Whether MIS is able to optimize the value of information?

10.22 AUDIT PLANNING, PROGRAMME, WORKING PAPERS AND REPROTING TO MANAGEMENT

Audit Planning

An Audit Plan should include the following:

- Objectives of the Audit- what is to be accomplished
- Scope of Audit
- Timelines within which to achieve the predetermined milestones
- Audit risk assessment procedure including strategies to respond to audit risks
- Methodology to be followed to conduct audit



Adequate planning helps to:

- (a) ensure that appropriate attention is devoted to important areas of audit;
- (b) ensure that potential problems are promptly identified;
- (c) ensure that the work is completed properly and in time;
- (d) utilize the assistants properly; and
- (e) Coordinate the work performed by others.

The auditor should consider the factors such as the complexity of audit, the environment in which the entity operates, his previous experience with the client and knowledge of client's business, while planning his audit work.

Audit Programme

An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.

(a) Advantages of audit programme

The main advantages of an audit programme are as follows:

- It serves as a ready check list of audit procedures to be performed.
- The audit work can be properly allocated to the audit assistants or the article clerks.
- The auditor may easily know the extent of work done at any point of time. Thus, the progress of work done can be under the supervision and control of the auditor.
- Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as he would be in a position to account for the individual responsibilities.
- A uniformity of the work can be attained as the same programme would be followed from time to time. It is a useful basis for planning the programme for the following year.
- It may be used as evidence by the auditor in the event when any charge is brought against him. He can prove that there has no negligence on his part and he exercised reasonable care and skill while performing the task.

(b) Disadvantages of Audit Programme

The main disadvantages of an audit programme are as follows:

- The auditor's task becomes mechanical and the auditors may lose interest and initiative.
- Drawing up of an audit programme may be unnecessary for a small concern.
- Though audit programme helps in fixing responsibilities but inefficient staff may defend themselves by stating that the matter was not contained in the audit programme.
- Rigid programmes cannot be laid down for each type of business.

Though an audit programme may suffer from the above disadvantages but these can be removed by taking some initiatives such as consulting the audit assistants, modifying the programme on the basis of experience gained during audit, etc

Audit Working Papers

Audit working papers are the record of the planning and execution of the audit engagement. Auditors retain a set of working papers for each audit engagement for each year. The audit working papers for the current year are

referred to as the current working papers. Working papers that are relevant to more than one audit engagement are often kept separately in a file referred to as permanent working papers. The audit working papers (current and permanent) for a client audit engagement are sufficiently detailed to enable another appropriately experienced and competent auditor that is not familiar with the client to obtain an overall understanding of the engagement.

Working papers (or documentation) serve three purposes (i) aid in planning and performance of the audit; (ii) aid in supervision and review of the audit work; and (iii) these papers serve as an evidence of the audit work performed by the auditor to support his opinion.

These working papers also facilitate audit planning and supervision of the audit work. The form and content of working papers vary from audits to audits, but they are affected by the following matters:

- (a) nature of engagement;
- (b) form of audit report;
- (c) nature and complexity of client's business;
- (d) nature and condition of client's records
- (e) degree of reliance of internal controls;
- (f) supervision of work performed by assistants.

Types of working paper files In case of recurring audits, some working papers files may be classified into permanent audit files and current audit files: while the former is updated with the Information of continuing importance, the latter contains information relating to audit of a single period. The contents of these files are given below:

Permanent Audit File	Current Audit File
(a) Legal and organizational structure of the entity, e.g. MOA and AOA in case of a company.	(a) Correspondence relating to acceptance of annual reappointment.
(b) Extracts or copies of legal documents, agreements and minutes relevant to the audit	(b) Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.
(c) A record if study and evaluation of internal controls.	(c) Copies of management letters.
(d) Analysis of significant ratios & trends.	(d) Analysis of transactions and balances
(e) Copies of the audited financial statements of previous year(s).	(e) Copies of communication with other auditors, experts and third parties.
(f) Notes regarding significant accounting policies.	(f) Audit programme.
(g) Significant audit observations of the earlier years.	(g) Conclusions reached on significant aspects of audit.

Working papers are the property of the auditor, the portions or extracts of which can be had at his discretion. These working papers should kept in safe custody and in confidential manner for such time as is sufficient to meet the requirements of his practice or to satisfy any related legal or professional requirement of record retention.

Audit Report

An audit report is a formal document where internal formal document where internal audit summarizes its work on an audit and reports its findings and recommendations based on that work.

Audit report will be an indicator of the usefulness of the internal audit functioning in the organization. Before setting out the report writing as well as in the process of report writing the following should be the guidelines :

- Clear thinking
- To whom the report is directed
- Purpose and aim of reporting



- At what stage the report writing to start
- Pattern of presentation
- Keep the reader uppermost in mind
- Translate technical matters to layman's language
- To visualize the reader's viewpoint
- Unbiased approach
- To mention the view point of the auditee
- Impact of the report or, in other words, what be the probable reaction to reporting whether action or decision will follow in quickest possible time or to be treated as of academic interest only.
- To remember the universal saying – "don't jump to conclusions"
- Facts and figures to be in proper sequences
- Cool and calm thinking to have logical and coherent presentation.

Proper setting out of internal audit report can be significant if it contains complete and logically developed appraisal with ample background facts and figures. It will be heartening to note if the top management accepted the significance and importance of the internal audit report as a useful tool for future improvements.

The main factors to go into the consideration for the various ways of presentations of written reports are :-

- Nature of business of the organisation.
- Nature of subject or aspect appraised.
- For whom the report is intended.
- Purpose for which the report is prepared.
- Management attitude, directives and needs.
- Internal auditor's approach and caliber.
- Extent of emphasis on audit findings and recommendations.
- Extent of details required by auditee and management.

The usual modern trend in presentation of internal audit report is as follows :-

- Detailed report about the findings, observations and recommendation is submitted to the auditee.
- Aspects which are of minor importance do not appear in the "detailed report" but discussed with all concerned and action taken by the auditee for implementation. These aspects can take the shape of a letter form of report to record the recommendations and the implementation thereof.
- Matters of major importance and on which top management has to take action for implementation of the recommendations are reported as "highlights of the report' to top management."

SUMMARY REPORT TO TOP MANAGEMENT

It may be the policy of the management to have copies of the Internal Audit Report in which there might be important findings. In such cases, the copy that might be endorsed to the top management should contain a summary sheet giving gist of the audit report. It should be appreciated that top people are busy and have not much time to spare to go through the detailed report. The list should highlight the conclusion and the remedial suggestions to correct the deficient conditions. The management would then be able to get an idea of the audit findings easily with minimum loss of time. The necessary details might also be referred to from the detailed report.

Summary reports to management usually would have two distinct functions –

- (i) They would tell what the internal audit department has accomplished when compared to what was planned.
- (ii) They would show conclusions of the auditors in a summarised form.

The significant ones may be advised to be corrected immediately, leaving the less important ones for taking action a bit later. Such report should be under distinct subheads like the following :-

- (i) Major irregularities needing immediate attention.
- (ii) Routine irregularities of consequence.
- (iii) Case of supervisory lapses which may result in heavy loss etc.

In the first category irregularities like non-maintenance of stock account of receipt books, meeting departmental expenditure from cash collected in violation of the instructions in this regard may be included. In the second category may come non-posting of entries to make records like stock cards etc. up to date, non-reconciliation of control accounts with the subsidiary ledger etc. In the third category may be included absence of supervisory check in the cash books, bill register, absence of supervisory percentage checking of the suppliers/contractors bill etc.

10.23 INTERNAL AUDIT PROGRAMME – INDUSTRIES SPECIFIC

(A) INTERNAL AUDIT PROGRAMME IN PLANTATION INDUSTRIES

INTRODUCTION

1. Importance of Plantation Industry in Indian Economy in terms of total turnover, employment generation, etc.:

Plantation Industry plays an important role in Indian economy in terms of both economic value addition as well employment generation as the Indian economy is still predominately an agrarian economy. Further, the following three industries constitute a major share of the total plantation industry:

- (i) Tea plantation;
- (ii) Rubber plantation;
- (iii) Coffee plantation.

Total size of these three industries taken together in terms of turnover is ₹..... Besides this, plantation industry, particularly, Tea and Coffee, are also the two major foreign exchange earners of the country.

Plantation Industry is the employment provider to a large mass of people, particularly, in the areas inhabited by backward classes and tribes whose level of skill is much lower in comparison to the skill of urban industrial labour. The above three industries taken together provide direct employment to 2.02 million workers and provides indirect employment to another population of size almost double the above figure. In some part of the country, for example, North-Eastern Region, economy mostly revolves around the plantation industry.

2. Unique features of Plantation Industry :

Plantation Industry is the only industry where the total activities, starting from the agricultural activities involving the production of raw-materials to the manufacturing activities for finished products are located at the same place under the umbrella of the single management. In case of most of the organisations engaged in plantation industry, the organisation handles all activities pertaining to production of raw-materials, production of finished products and marketing of the finished products also.

At the Estate level, the strength of the managerial staff is much less as compared to the total number of workers engaged. The ratio of the total number of managerial staff to the total number of workers is much lower than the same ratio for other industries. At the Estate level, most of the managerial staff has to handle multiple operational functions like overseeing the agricultural activities, manufacturing, labour management, office administration etc.



Plantation Industry is highly labour intensive. Not only that, majority of the workforce directly attached with the plantation industry reside in the labour quarters situated within the Estate. As a result, the Management has to look after the total maintenance of the labour quarters, maintenance of law and order situation as well as general administration of labour lines and smooth provisioning of the entitlements to which workers are entitled statutorily.

The output in plantation industry is also highly dependent on the climatic condition.

3. Needs of Plantation Industry for a strong Internal Control System and consequent importance of integrated and well-organised Internal Audit System in Plantation Industry :

The basic nature of Plantation Industry and its unique features demand the existence of a strong internal control system in Plantation Industry due to the following reasons :

- (i) As the field productivity of the raw materials vis-à-vis the quantum of output is highly dependent on the condition of the weather – common to any agro-based product, the input-output ratio cannot be fixed rigorously and at the same time, the total quantum of output of final product cannot also be forecast with substantial accuracy many a times;
- (ii) The total operation of the Estate is controlled by a few managerial staff as compared to the vastness of the area of the estate and variety of operational functions involved;
- (iii) Because of this vastness of the total area of any Estate being looked after by a small number of managerial staff usually, it becomes very difficult to exercise personal managerial supervision in all cases;
- (iv) Sometimes, It becomes difficult to exercise the managerial supervision on the workers, to the fullest extent considering the low ratio of managerial staff and the number of workers and the Estate Management has to depend on the supervisory staff for most of the operations.

In view of the above factors, any plantation industry requires a strong well-structured internal control system to achieve the economic viability of the Industry as well as its smooth operation. Consequently, the existence of an integrated and well-organised Internal Audit System is very important in Plantation Industry because a structured Internal Audit system will continuously assess the existence and effectiveness of the internal control system in all the operational areas. Internal Audit will point out any gap found in the Internal Control system in all the operational areas and will also facilitate the continuous improvement in the Internal Control System and procedures.

To achieve these objectives, Internal Auditors have to take a pragmatic and practical approach while framing the Internal Audit Programme and also in preparation of the Internal Audit Check List without compromising with the professional requirements. Internal Auditor shall also apprise himself of the basic features and peculiarities of the Industry and also the age-old established practices prevalent in the Estate. In any agro-based Industry, there are certain customs and practices prevalent in a particular region which have very important role to play in the operation of agriculture in that particular area and in maintaining smooth industrial relations.

MODEL INTERNAL AUDIT PROGRAMME

1. Sales :

1.1 For Tea

- (i) Auction Sales & Private Sales :
 - (a) Price recovery of each sale - Comparison with Brokers Valuation - Comparison with Sale Average of respective Auctions as well as Price realized by neighboring gardens or the Circles to which the estate belongs;
 - (b) Comparison of Price recovery between Auction Sale & Private Sale;
 - (c) Crop Book ;
 - (d) Allocation of Tea among Private Sale & Out-market sale;

- (e) Realisation of Sale proceeds – both Private Sale & Auction Sale;
 - (f) Payment of Brokers' Commission;
 - (g) Review of Debtors' Ledger .
- (ii) Export Sale :
- (a) Fixation of price ;
 - (b) Approval of samples ;
 - (c) Shipping of Consignment ;
 - (d) Realisation of Sale Proceeds ;
 - (e) Realisation of Export Benefits.

1.2 For Rubber :

- (a) Review of the customer base of different grades of rubber i.e. Cenex, Crumb (Indian Standard Natural Rubber or ISNR), Skim Crepe, Sheet Rubber etc. ;
- (b) Process of fixation of Sales Price ;
- (c) Examination of customers' Purchase Orders ;
- (d) Process of Invoicing including compliance of Statutory requirements of the Rubber Board and Sales Tax/ VAT Act of the respective States ;
- (e) Realisation of Sale Proceeds including review of Debtors Ledger .

2 Warehousing:

- (a) Examination of process of selection of warehouses and fixation of warehousing charges;
- (b) Scrutiny of the contracts with warehouses;
- (c) Examination of process of documentation at warehouses relating to receipt of material, despatch of material;
- (d) Physical verification of warehouse stock;
- (e) Examination of warehouse records.

3. Transportation Contract – for Finished Products & Stores Materials :

- (a) Examination of process of selection of Transporters;
- (b) Examination of credentials of Transporters;
- (c) Fixation of Rates of transportation – Full Lorry Load & Part Lorry Load;
- (d) Examination of terms of contract with the transporters including price variation clause;
- (e) Checking the system of processing the bills of the transporters;
- (f) Checking the system of recovery from the transporters, of the cost of damages / loss in transit/ shortages;
- (g) Examination of system of maintenance of related records.

4. Insurance Matters :

- (a) Examination of Policy Coverages;
- (b) Examination of Adequacy of Policy Coverages;
- (c) Insurance Claims & Realisation of Insurance Claims;
- (d) Scrutiny of Records pertaining to Insurance Claims;



(e) Review of Status of outstanding claims.

5. Purchase :

- (a) Review of Purchase Policy with special emphasis on procurement of agricultural inputs, machinery spares and packing materials;
- (b) Examination of individual Purchase transactions with reference to Company's Purchase Procedure;
- (c) Examination of local purchase transactions made at estates with reference to the company's purchase policy and laid down procedure, if any ;
- (d) System of payment to Suppliers including payment of advance, recovery of advance paid to suppliers – Scrutiny of outstanding advance to suppliers.

6. Capital Expenditure :

- (i) Capital Budget;
- (ii) Procedures followed for decision regarding specification, design, manufacturer, etc. for Capital assets to be procured;
- (iii) Examination of the Credentials of the Vendors submitting quotations;
- (iv) Authorisation & Placement of Order for procurement;
- (v) Installation of Capital items.

7. Purchase of Green Leaf :

- (i) Selection of suppliers;
- (ii) Fixation of Price with reference to fine leaf count;
- (iii) Records relating to daily receipt of consignments of purchased Greenleaf;
- (iv) Records relating to leaf count of Bought Leaf;
- (v) Recovery % age of Bought Leaf

8. Purchase of Field Latex :

- (i) Selection of supplier;
- (ii) Fixation of Price vis-à-vis Dry Rubber Content (DRC) % age;
- (iii) Records relating to receipt of consignments;
- (iv) Records pertaining to measurement of DRC % age – consignment-wise.

9. Slaughter Tapping :

- (i) Selection of Contractors;
- (ii) Fixation of price and realization of sale proceeds with reference to terms of contract;
- (iii) Fixation of Price for buy-back of field latex collected through slaughter tapping;
- (iv) Records relating to measurement of DRC percentage;
- (v) Payment for field latex bought back.

10. Civil Construction & Other Contracts including Contracts for Repairs to Building, Machinery & Vehicles:

- (i) System of awarding contracts – Selection of Contractors – Fixation of rates and other Terms & conditions;
- (ii) Process of minor repairs to Buildings, e.g. Bungalows, Labour Quarters, Factory, etc.;
- (iii) Maintenance of Measurement Book;

- (iv) Monitoring progress of work & Bill Passing;
- (v) System of payment to Contractors including payment of Advance Examination of maintenance of records of expenditure of individual assets
- (vi) Checking of comparative expenditure on vehicles, machinery items & buildings for last 3 / 4 years;
- (vii) Control system for issue of machinery & vehicle spares for repairs within the Estate;
- (viii) Control system for repair of machinery & vehicles in Workshops outside the Estate;
- (ix) Maintenance of Accounts for materials consumed in respect of civil construction/ repairs done internally;
- (x) Examination of major expenditures incurred within the year, in particular the expenditure on overhauling of machinery.

11. Cultivation :

- (i) Examination of Land Records, Cadastral Map, Drainage Map, etc.
- (ii) Examination of Standard task fixed for each agricultural operation to measure output and procedure followed for such fixation of tasks.
- (iii) Drainage : Checking of Drainage Program and its implementation;
- (iv) Application of agricultural inputs :
 - (a) Checking of program for application of agricultural inputs, i.e. Manure, Pesticides, Weedicides;
 - (b) Checking of records for application of agricultural inputs;
- (v) Checking of Maintenance of records for other agricultural operations
- (vi) Weighing of raw-materials at field – Green Leaf, Coffee seeds & field latex - Checking of procedures followed for weighment of Green Leaf/ Coffee Seeds and Field Latex including maintenance of relevant records;
- (vii) System of control for stock of Sprayers;
- (viii) Maintenance of records for DRC percentage (in case of rubber) of daily collection of field latex by individual workers for payment of wages and incentives to tappers;

12. Yield Analysis vis-à-vis Examination of Vacancy Percentage :

- (i) Examination of Section No./Field No. wise Yield Record;
- (ii) Study of Section/Field No. wise Comparative Yield Analysis;
- (iii) Study of the yield of the Sections/ fields planted/replanted in last 10 yrs;
- (iv) Study of the low yielding sections/ fields;
- (v) Examination of system of identification of vacancy in Sections/ Fields;
- (vi) Examination of records pertaining to Vacancy;
- (vii) Examination of Rehabilitation Programme for reduction Vacancy Percentage.

13. Extension Planting/ Replantation :

- (i) Programme for new extension/ replantation for the year under audit and next 5 years;
- (ii) Basis of selection of replantation areas;
- (iii) Budget for extension planting/ re-plantation;
- (iv) Implementation of Extension/ Replantation Programme;
- (v) Examination of expenditure on uprooting (in case of replantation) and records pertaining to measurement of uprooted tea bush, coffee plants, shade trees and rubber trees and their subsequent utilization / sale;



- (vi) Records maintained for areas under Extension planting/ Replantation;
- (vii) Expenditure on Plantation and Maintenance of newly planted /re-planted area;
- (viii) Analysis of Cost per Hectare for plantation / replantation and on maintenance in respect of individual section Nos./ field Nos.;
- (ix) Compliance with the formalities for availing incentives from Tea Board/ Rubber Board for Extension planting & replantation;
- (x) Year-wise yield analysis for the sections/ fields which have come into bearing in last 7 years.

14. Nursery :

- (i) Budget for requirement of Plants for next 3 years for Planting & infilling
- (ii) Plan for Nursery including type of Nursery – Clonal or Seedlings;
- (iii) Examination of Nursery records;
- (iv) Examination of Nursery Expenses and utilization of materials;
- (v) Examination of Nursery Cost :
 - (a) Actual cost per plant vis-à-vis budgeted cost per Plant;
 - (b) Cost per Plant of Shade Nursery (for Tea only) vis-à-vis Budgeted Cost per Plant;
- (vi) Verification of Plantation Records;
- (vii) Survival/ Success percentage of Nursery;
- (viii) Verification of Nursery Plant – Reconciliation Statement;
- (ix) Treatment of cost of damaged plants in course of planting;
- (x) Valuation of Closing Stock of plants;

15. Deployment :

- (i) Examination of system of Planning & related records,
- (ii) Comparison between Work Order Book and Actual Deployment,
- (iii) Verification of Deployment records,
- (iv) Field Productivity of Labours –
 - ✓ Pluckers' Productivity (in case of Tea),
 - ✓ Productivity of Labour for peaking Coffee Seeds;
 - ✓ Tappers Productivity (in Rubber plantation);
 - ✓ 3 / 4 Years' comparative analysis for the above – Permanent, Casual workers separately and in totality
- (v) Fixation of Task of all types of agricultural operations
- (vi) Factory deployment – Deployment of Casual Workers, Overtime work, Shift working along with system of OT payment, Productivity of Factory Workers.
- (vii) Deployment of Labours in non-productive areas – Comparative study in respect of the earlier years.
- (viii) Study of actual pattern of deployment of labour – both permanent & Casual in Cultivation, Manufacture, Plucking/ Tapping/ Picking, Stripping & Gleaning of Coffee Seeds and other operations including establishment.
- (ix) Reconciliation of wages as per final Deployment Book with Wages as per monthly Accounts.

16. Wages :

- (i) Checking of Master Roll, Pay Roll vis-à-vis Actuarial Valuation List prepared for the purpose of computation of Gratuity;
- (ii) System of recording the attendance;
- (iii) Scrutiny of attendance / absenteeism record – for Staff, Sub-staff & Workers;
- (iv) Verification of final Deployment Book with the Field (i.e. rough) Deployment Book/ Record as well as Daily Attendance Record ;
- (v) Checking of procedure followed for disbursement of wages, bonus etc;
- (vi) Checking of records for unpaid Wages & unpaid Bonus and their subsequent disbursement;
- (vii) Checking of computation of Wages of Casual/ Contractual Workers with reference to basic records maintained for recording their attendance;
- (viii) Checking of Payment Vouchers for disbursement of Wages to Casual/ Contractual workers;
- (ix) Checking of basic records maintained for payment of incentives, i.e. for plucking, tapping, picking of Coffee Seeds with reference to minimum task fixed;
- (x) Procedure followed for recovery of Cost of electricity provided to Staff/ workers' quarters and records maintained there for;
- (xi) Procedures followed for recovery of cost of food stuff issued to workers,
- (xii) Payment of Sick Allowance, Maternity Benefits, Leave with Wages, Holiday Wages, Bonus including records maintained there for;
- (xiii) Checking of system of payment of Overtime;
- (xiv) Procedure for payment of Advance to Staff/ Workers and Management Staff and their recovery including records maintained therefor;
- (xv) Checking of computation of Leave with Wages and their disbursement.

17. Miscellaneous Labour Welfare Expenditure :

- (i) Examination of expenditure on different labour welfare items including the study of trend of expenditure for a period of consecutive 3 / 4 years;
- (ii) Fire wood or other form of fuel to be issued to staff and workers - Procurement process including fixation of price, records for issue of fuel and system of control exercised on issue;
- (iii) Procurement of other labour welfare items like Umbrella, Chappals, Blankets and other protective clothing, issue of those items and related records;
- (iv) System of issue of black tea to staff & workers in Tea Estates

18. Ration:

- (i) Procurement of Food Stuff
- (ii) Issue of Food Stuff – Comparison with entitlements as per Industry norms, deduction for absenteeism
- (iii) Comparison of Ration Issue Book with Census Records
- (iv) Physical verification of Stock of Food Stuff
- (v) Checking of percentage of handling loss on monthly & yearly basis – Comparative analysis of Handling Loss Percentage for a period of 3 / 4 years



19. Census :

- (i) Checking of Census Records
- (ii) Examination of method followed for updating the Census Records
- (iii) Examination of Land Labour Ratio with reference to Industry norms

20. Medical Benefit & Expenditure :

- (i) Purchase & consumption of Medicine at Estate's Hospital
- (ii) Expenditure incurred on Hospital
- (iii) Maintenance of records at Hospital
- (iv) Treatment at outside Hospital – Review of Procedure followed, Records maintained for the patients sent to such hospitals and expenditure incurred, system of payment to such hospitals
- (v) Recovery of cost of treating non-workers who are not dependent of the Estate workers
- (vi) Checking of records for payment of Sick Allowance and Maternity Benefits and cross-check same with Accounting Records – system followed for payment

21. Gratuity :

- (i) Verification of Gratuity Payment including checking of gratuity computation;
- (ii) Maintenance of Statutory records;
- (iii) Compliance with Payment of Gratuity Act & Rules;
- (iv) Examination of pending cases of unpaid Gratuity;
- (v) Status of nomination form;

22. Production :

- (i) Verification of records maintained for weighment of raw-materials at factory;
- (ii) Checking of Machine Log Books;
- (iii) Verification of maintenance of Production records i.e. raw-material register, RG-1, RT-12, Packing records, Despatch records;
- (iv) Excise Records;
- (v) Checking of system of measurement of Finished Goods including records thereof;
- (vi) For Tea Manufacturing – Examination of Sorting, Packing & Despatch records, assessment of accumulated stock of unsorted, unpacked stock of Tea and Stock awaiting dispatch – reasons thereof
- (vii) Checking of system of dispatch of Finished Goods & records pertaining to dispatch and stock of finished goods;
- (viii) System of issue of Tea to Labour/ Staff & Management Staff, maintenance of related records
- (ix) For Tea manufacturing - Analysis of Recovery percentage, Tea Waste Percentage, Percentage of Primary & Secondary grades and Comparative analysis for 3 / 4 years figures.;
- (x) For Rubber manufacturing – method of computation of volume of Production, Manufacturing Loss Percentage, Productivity of different Production Centers;
- (xi) For Coffee – Percentage of out-turn of clean Coffee, Percentage Component of Cherry & Perched Coffee.

23 Inventory Control :

- (i) Checking of system of receipt/ issue of Stores,
- (ii) Verification of Stores Records,
- (iii) Physical verification of Stores, Verification of utilization of Stores,
- (iv) Assessment of Status of Slow Moving & Non-moving Stores Items.
- (v) Checking of records including physical verification of Stores and Tea;

24 Power & Fuel :

Vehicle Log Book :

- (a) Comparative Study of Fuel Consumption-individual vehicle-wise;
- (b) Consumption of fuel – Quantitative Reconciliation between Log Book and stores record.

Power Consumption :

- (a) Electricity Consumption;
- (b) Gas consumption;
- (c) Coal & TD Oil Consumption;

Generator Log Book :

- (a) Generator Set fuel efficiency ;
- (b) Reconciliation with Stores Records .

25. Fixed Assets :

- (i) Checking of maintenance of records including recording of Addition, Deletion & Disposal
- (ii) Physical verification of Assets
- (iii) Assessment of status of unutilized assets, specially machinery & vehicles

26. Scrap :

- (i) Maintenance of Scrap records for both generation and disposal
- (ii) Physical stock of scrap – its maintenance & security
- (iii) Procedures followed for disposal of scrap

27 Statutory Matters :

Tax Deducted at Source (TDS) :

- (i) Basis of deducting TDS;
- (ii) Deduction and deposit of TDS
- (iii) Filing of TDS Return

Service Tax :

- (i) Deduction and deposit of Service Tax;
- (ii) Filing of Service Tax Return

Deposit of Statutory Dues :

- (i) Deduction and deposit of Provident Fund (PF);
- (ii) PF Annual Return;



- (iii) PF Annual Administrative Charges;
- (iv) Pending PF Settlement
- Deposit Linked Insurance (DLI & DLI Administrative Charges);
- Excise Records & Excise Returns ;
- Green Leaf Cess ;
- VAT / Sales Tax ;
- Profession Tax (P Tax)
- Status of Licenses & Returns
- Land Revenue

28 Accounts :

- (i) Verification of Bank Book;
- (ii) Verification of Cash Book;
- (iii) Bank Reconciliation Statement (BRS);
- (iv) Cash Vouching;
- (v) Physical Verification of Cash;
- (vi) Review of Creditors' Ledger and List of other Liabilities;
- (vii) Scrutiny of Advance given to Staff/ employees :
 - (a) PF Advance;
 - (b) Medical Advance;
- (viii) Status of Recovery of Labour Line Electricity Bills (where bills are paid by the employer)
- (ix) Scrutiny of Advance A/c in respect of Advances paid to Suppliers, Service providers , Contractors and Miscellaneous purposes ;
- (x) Security Deposit ;
- (xi) Maintenance of Cost Records.

(B) Gist of Internal Audit Programme in Steel Industries

Direct Reduced Iron (DRI)

Sponge – iron is a metallic product produced through direct reduction of iron ore and iron – ore pellets in the solid state. It is also known as Direct Reduced Iron (DRI) or Hematite iron ore which is used for reduction. After reduction of iron ore the product resembles sponge because of pores left behind after removal of oxides. As such it is called sponge iron. Sponge iron is a substitute of scrap in steel melting.

There are mainly two routes of iron making:

- (a) Blast furnace
- (b) Direct reduction

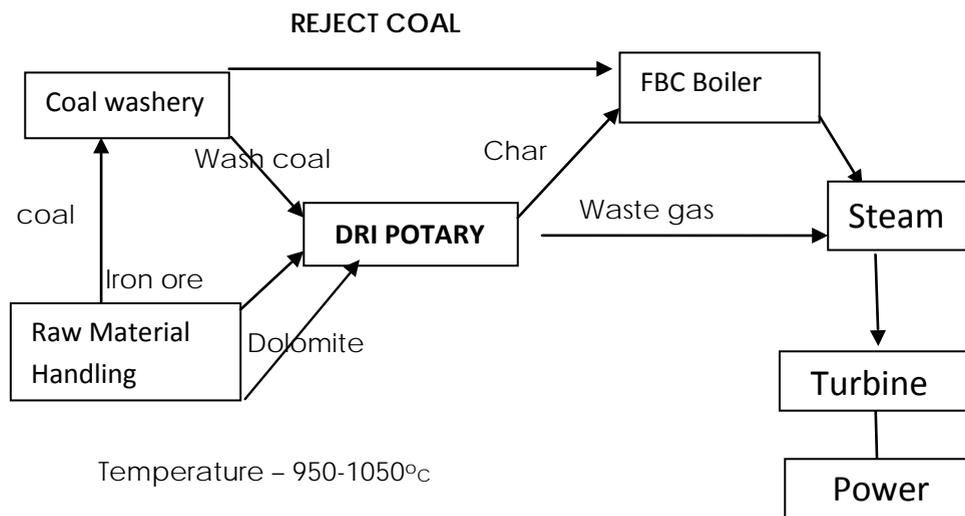
Direct reductions is further divided in two routes:

- (a) Gas based
- (b) Coal based

The gas-based route is less preferred due to project cost, use of imported coke and relatively longer gestation period. Coal based DRI process is mainly preferred on account of comparatively lower project cost, better R.O.I crisis of scrap for steel making, international/ national demand of solid metrellic and availability of large reserves of high grade iron ore & non- coking coal in India . Although the reduction inside kiln is not direct as Co formation inside kiln takes place but because the reduction its taking place in solid state without meetings as such this process is called direct reduction process.

(1) Process:

Iron-ore, wash coal & dolomite are fed in different proportions from the feed end. Injection cola lumps & injection coal fines are injected from out late , about 40-45% of the total coal is charged from the feed end & remaining 55-60% of the coal is pneumatically injected into the kiln from the discharge end, dolomite is feed in proportion of 2- 4% of iron ore.



(2) Raw materials required to manutaetme sponge iron

For making one – tone sponge iron following raw materials required (standard) as below

- Iron ore = 1.70 to 1.80 tonnes
- Pellets = 1.50 to 1.55 tonnes
- Coal = 1.35 to 1.45 tonnes
- Dolomites = 50kg

(3) Standards Quality raw material required for iron making

(a) Iron – ore

- (i) Fe (T) = 65% min
- (ii) Al 2O3+ SiO2 = 5% max
- (iii) Pumbles Index = 88%
- (iv) Abrasion Index = 5% min
- (v) Thermal degradation index = 5 max
- (vi) Size = 5-20mm



(b) Chemical Composition

- (i) Gangue content of ore feed should not exceed 5%
- (ii) Silica (SiO_2) = 2%
- (iii) Alumina (Al_2O_3) content does not appear to be of significance from reduction point of view
- (iv) Phosphorous (P) = below 0.03% (normal in India 0.03 to 0.08%)
- (v) Sulphur (s) = below 0.02%

(c) Non – coking Coal

- (i) F.C. = 46% min
- (ii) V.M. = 30% Max
- (iii) Ash = 24% Max
- (iv) Moisture = 10% max
- (v) Ash fusion temperature = 128°C min
- (vi) Reactivity (Min) = 1.8 cc of co/Gm of/c/sec
- (vii) Size (Feed Coal) = 5-20 MM
- (viii) Size (inj/coal Lumps) = 3-20MM
- (ix) Size (inj/coal Lumps) = 0- 3MM
- (x) Caking/ swelling induce = 1% max

(d) Dolomite

- (i) CaO = 28% Min
- (ii) MgO = 18% Min
- (iii) SiO_2 = 04% Max
- (iv) Size = 2-6 MM

Wastage: - In DRI plant nothing is wastage. Coal fines transfer to sinter plant.

SINTER PLANT

Sintering is a process of agglomeration of Iron ore fines into a porous hard mass by INCIPIENT FUSION due to the heat generated within the mass itself.

Or

Sintering may be defined as the process agglomeration, where heat is produced by combustion of solid fuels within moving beds of loosely packed particles i.e. iron ore and other raw materials into a compact porous mass.

Quality of Input material

- (i) Ore fines (90% - 10mm)
- (ii) Lime stone (90% - 03 mm)
- (iii) Dolomite (90% - 03mm)
- (iv) Coke fines (90% - 03mm)
- (v) Sand/Quartzite (90% - 03mm)
- (vi) Plant wastes like fine dust, Mill seals, bag Fitter, Dust etc.

Output

Sinter (5- 40mm)

Need of Sintering

The porous mass, which is called sinter, is used in blast furnace as an iron bearing, preponed charge material for production of Hot Metal for the following reasons:-

- (i) To utilize the times generated during the mining operations or in plant generation
- (ii) To utilize different additives like mill scale, flue dust, Bag fitter dust, rejected lime fines etc. chemical demand of the blast furnace.
- (iii) To produce hot metal with better consistency.
- (iv) To reduce cost of hot metal by reduction of coke rate
- (v) To increase Blast furnace performance & productivity.

Types of Sinter

- (i) Non Fluxed or Acid sinters :- Those where no flux is present or is added in the ore.
- (ii) Basic sinter or self fluxing sinter:- Those where sufficient flux has been added in the sinter mix to provide a basicity that is desired in the final slag, taking into consideration only the burden acids, An extra flux is added to the burden while charging to coke ash acids.
- (iii) Super basic or super fluxed sinter: - In these types of sinters an additional flux is added to the mix to provide for the desired final slag basicity, taking into account the acids content of both ore as well as the coke ash.

Input material

Sinter plant is made to utilized the waste generated during mining operation or in plant question as follows

- (i) Iron ore fines
- (ii) Blast Furnace fines
- (iii) Sinter return fines
- (iv) ESP Dust (Electro Static Precipitation)
- (v) Dolomite fines
- (vi) Lime stone fines
- (vii) Coke fines
- (viii) All other metal lurgical waste like mill scale, flue dust, Bag fitter dust & river sand are collected. Temperature required = 800^o - 1200^oC

Blast Furnace

The purpose of Blast furnace is to chemically reduce and physically convert iron oxide into liquid iron called "hot metal"! The blast furnace is a huge, steel lined with refractory brick where iron ore, coke and limestone are charged into the top and pretreated air is blown into the bottom. The raw materials require 6 – 8 hours to descend to the bottom of the furnace where they become the final product of liquid slag and liquid iron. These liquid products are drained from the furnace at regular interval. The hot air that was blown into the bottom of the surface as cends to the top in 6 to 8 seconds after going through numerous chemical reactions' once the blast furnace is started it continuously runs for four to ten years with only short stops to perform planned maintenance.

Iron oxide is charged into the blast furnace plant in the form of raw ores, ballets or sinter. The raw ore is extracted from the earth and sized into piece that range from 0.5 to 1.5 inches. This ore is mainly Hematite (Fe 203) with or without small amount of magnetite (Fe 304) and the iron contents ranges from 50% to 70%. This iron rich ore can be changed directly into blast furnace without any further processing iron that contains a lower iron contents must be processed or beneficiated to increase its iron contents pallet are produced from this lower iron content ore. This ore is crushed and ground into a powder so the walte material called gangue can be removed. The remaining iron rich powder is volled into balls and fired in a furnace to produce strong, marble sized pellets that conteinte 60.5 to 65% iron. One more agglomeration process is called sintering. Sinter is produced from fine raw ore, small coke, sand sized lime stone and nemerous other steel plant waste material that contain some iron. These time materials are proportioned to obtain a desired product chemistry then mixed together. This raw material mixed is then



placed on a sinteins stand, which is similar to conveyor belt, where. It is ignited by gas fived furnace and fused by the heat from the coke fines into larger size pieces that are from 0.5 to 2.0 inch. The iron ore, pellets and sinter then are charged into blast furnace to produce liquid iron, with any of their remaining impurities going to the liquid slag.

The another raw materials in the iron making process is lime stone, dolomite and quartz together with coke. The one removed from the earth by blasting with explosives. It is then crushed and screened to a size that ranges from 0.5 inch to 1.5 inch to charge into the blast furnace to act as flay. These fluxes help to remove out gangue from blast furnace in the from of slag.

The iron ore, pellets and sinter are reduced which simply means the Oxygen in the iron. Oxide is removed by a series of chemical reaction. While, going through these purifying readions, the iron oxide gets soften and finally converts into motter from that trickles as liquid iron throuly the coke to the bottom of the furnace. The coke descends to the bottom of the furnace to the level where the preheated air or hot blast enters the blast and immediately reacts to generate heat.

Finished products

- (i) The metal
- (ii) The slag
- (iii) The gas

The metallic product from a blast furnace is variously known as hot metal and pig iron. It contains carbon, silicon, phosphorus, manganese and surplus as the chief impurities totaling anything upto 6% by weight or so. Since the liquid iron trickles through coke lumps in the bosh region it gets saturated with carbon may very around 3.5 – 4.2% slag granules are produced in a granulation plant where motter slag is poured in turbulent water. These slag granules are sent to cement plants.

The blast furnace would produce an effluent gas containing a significant proportion of carbon monoxide, which cannot be used for iron oxide reduction. The quantity of gas produced depends upon amount of fuel burnt. The actual Co content varies around 20 – 30% by volume. The gas is therefore cleaned before its use and in so doing the sensible heat of the gas is invariably lost.

STEEL MELTING SHOP

The Hot Metal that comes from Blast furnace through ladle after purifying and rending the percentage of carbon, sulpher and phosphorous, the not metal is converted into steel.

Weight%

Input -- Hot metal = 46 - 50

DRI = 40.45

Scrap = 1.54 – 2.0

Burn Lime = 5.3 – 5.5

Burn Dolo = 4.5 – 5.0

Furnace operations

The electric are furnace operates as a batches melting process producing batches of molten steel know "heats". The electric are furnace operating cycle is called the tap – to – tap cycle and is made up the following:

Operations:

- (i) Furnace charging
- (ii) Melting
- (iii) Refining
- (iv) De – Slagging
- (v) Tapping
- (vi) Furnace turn- around.

Modern operations aim for a tap – to – tap time of less than us minutes.

Output

Combi Caster = Beam blank or Round.

Billet caster = Round, 130 X 130mm, 150X150mm, 200X200mm

Slab caster = Width 1300mm to 2600mm thickness 215mm, 250mm and 280mm.

Rail & universal Beam Mill

At Rubna a mixture of blast furnace gas, furnace oil and produce gas is used to fire the furnace walking beam furnace has been commissioned for reheating. The moveable grid moves 75 mm upward, 500mm forward, 150mm downward and finally 500mm backward.

Blooms remain in the furnace for about 4 hours. For beam blanks the temperature setting are 1130, 1250, 1270 degree Celsius for preheating, heating and soaking zone respectively.

Hot Saw

Two parallel lines, each with one Hot saw, provide alternate routes for the hot rolled products exiting from the finishing stand. The hot saws are fitted with lambaton stoppers, which move in version to temperature and profit length to ensme exacting finish lengths post cooling

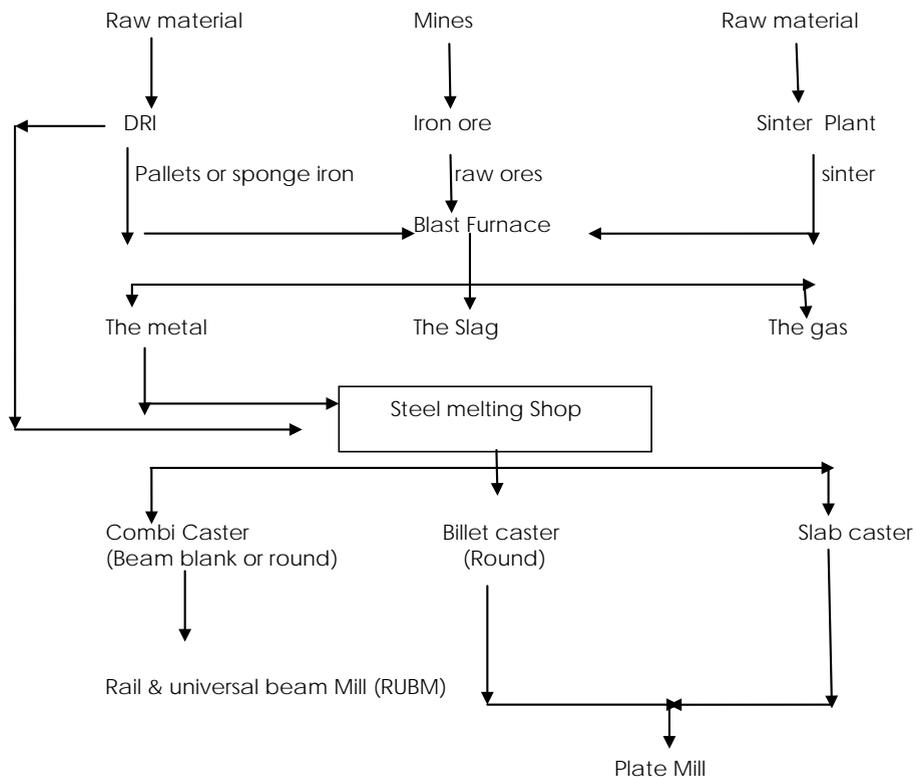
Cooling Bed

Walking beam type cooling bed capable of 120m long rolled products in installed in RUBM. Cooling bed is preceded by Hot saws and automatic rail stamping machine and is especially designed to finish 120m long rail road rails to be produced for the first time in. It in the iron ore, iron contents ranges from 50% to 70% then this iron rich ore can be changed directly into blast furnace without any further processing.

Further, iron ore that contains a lower iron contents must be processed or beneficiated to increase its iron contents so pallet are produced from this lower iron content ore.

This ore is crushed and ground into a power so that waste material called gangue can be removed.

SMS: - By purification and reducing the percentage of carbon, sulphur and phosphorous, the hot metal is converted into steel.



Study Note - 11

INTERNAL AUDIT IN DIFFERENT SECTORS



This Study Note includes

- 11.1 Audit of Hospitals
- 11.2 Audit of Hotels
- 11.3 Audit of Educational Institutions
- 11.4 Audit of Co-operative Societies
- 11.5 Audit of Self-Help Groups
- 11.6 Audit of Non-Governmental Organisations (NGOs)
- 11.7 Audit of Local Bodies
- 11.8 Government Expenditure Audit
- 11.9 Propriety Audit in the Context of Government Audit
- 11.10 Audit of Commercial Accounts

11.1 AUDIT OF HOSPITALS

The following points are to be considered necessary for conducting an audit of Hospital.

- (i) Check the letter of appointment to ascertain the scope of responsibilities.
- (ii) Study the Charter or Trust Deed under which the hospital has been set up and take a special note of the provisions affecting the accounts.
- (iii) Examine, evaluate and verify the system of internal check, internal control and determine the nature, timing and the extent of the audit procedures.
- (iv) Vouch the entries in the Patient's Bill Register with a copies of bill issued. Test check the selected bills to see that these have been correctly prepared taking into consideration the period of stay of each patient as recorded in the Attendance Schedule.
- (v) Vouch the collection from patients with copies of bills and entries in Bills Register. Arrears of dues should be properly carried forward and where these are deemed to be irrecoverable, they should be written off under due authorizations.
- (vi) Interest and/ or dividend income should be vouched with reference to the Investment Register and Interest and Dividend warrants.
- (vii) In case of legacies and donations which are received for specific purposes, it should be ensured that any income therefrom is not utilized for any other purposes.
- (viii) Where receipts of subscription show a significant deviations from budgeted figures, it should be thoroughly inquired into and the matter be brought to the notice of the trustees or the Managing Committee.
- (ix) Government grants or grants from local bodies should be verified with the reference to the correspondence with the concerned authorities.
- (x) Clear distinction should be made between the items of capital and revenue nature.
- (xi) The capital expenditure should be incurred under proper authorization by a valid resolution of the trustees or the Managing Committee.

- (xii) Verify the system of internal check as regards purchases and issue of stores, medicines etc.
- (xiii) Examine that the appointment of the staff, payment of salaries etc. are duly authorized.
- (xiv) Physically verify the investments, fixed assets and inventories.
- (xv) Check that adequate depreciation has been provided on all the depreciable assets.

11.2 AUDIT OF HOTELS

The business of running a hotel is very much dissimilar to running an industrial unit for manufacturing of products. It is a service-oriented industry. The business is characterized by handling of large amounts of liquid cash, stock of foods providing a variety of services, and keeping watch on customers to ensure that they do not leave hotel without settling the dues. In view of these, the following matters require special attention by the auditor.

- (i) **Internal Control:** Pilferage is one of the greatest problems in any hotel and it is extremely important to have a proper internal control to minimize the leakage. The following points should be checked:
 - (a) Effectiveness of arrangement regarding receipts and disbursements of cash.
 - (b) Procedure for purchase and stocking of various commodities and provisions.
 - (c) Procedure regarding billing of the customers in respect of room service, telephone, laundry, etc.
 - (d) System regarding recording and physical custody of edibles, wines, cigarettes, crockery and cutlery, linen, furniture, carpets, etc.
 - (e) Ensure that trading accounts are prepared preferably weekly, for each sales point. A scrutiny of the percentage of profit should be made, and any deviation from the norms is to be investigated.
- (ii) **Room Sales and Cash Collections:**
 - (a) There are various sales points scattered in a hotel and sales are both for cash and credit. The control over cash is very important. The charge for room sales is made from the guest register, and tests are to be carried out to ensure that the correct number of guests are charged for the exact period of stay. Any difference between the rate charged to the guests and standard room rent is to be investigated to see that it is properly authorized.
 - (b) The total sales reported with the total bills issued at each sales point have to be reconciled.
 - (c) Special care must be taken in respect of bills issued to customers who are staying in the hotel, because they may not be required to pay the bills immediately in cash but at a future date or by credit cards. Billing is to be done room-wise. It must be ensured that all customers pay their bills on leaving the hotel or within specified dates.
- (iii) **Stock:**

The stocks in a hotel are all saleable item like food and beverages. Therefore, following may be noted in this regard:

 - (a) All movement and transfer of stocks must be properly documented.
 - (b) Areas where stocks are kept must be kept locked and the key retained by the departmental manager.
 - (c) The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
 - (d) Many hotels use specialized professional valuers to count and value the stocks on a continuous basis throughout the year.
 - (e) The auditor should ensure that all stocks are valued at the year end and that he should himself be present at the yearend physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories



- (iv) **Fixed Assets:** The fixed assets should be properly depreciated, and the Fixed Assets Register should be updated.
- (v) **Casual Labour:** In case the hotel employs a casual labour, the auditor should consider, whether adequate records have been maintained in this respect and there is no manipulation taking place. The wages payment of the casual labour must also be checked thoroughly.
- (vi) The compliance with all statutory provisions, and compliance with the Foreign Exchange Regulations must also be verified by the auditor, especially because hotels offer facility of conversion of foreign exchange to rupees.
- (vii) **Other special aspects are to be verified as under:**
 - (a) Consumption shown in various physical stock accounts must be traced to the customers' bills to ensure that all issues to the customers have been billed.
 - (b) All payments to the foreign collaborator, if any, are to be checked.
 - (c) Expenses and receipts are to be compared with figures of the previous year, having regard to the average occupancy of visitors and changes in rates.
 - (d) Special receipts on account of letting out of auditorium, banquet hall, spaces for shops, boutiques, and special shows should be verified with the arrangements made.
 - (e) In depth check should be carried out on the customers' ledgers to verify that all charges have been properly made and recovered.
 - (f) The occupancy rate should be worked out, and compared with other similar hotels, and with previous year. Material deviations should be investigated.
 - (g) Expenses for painting, decoration, renovation of building, etc. are to be properly checked.
 - (h) It is common that hotels get their bookings done through travel agents. The auditor should ensure that the money is recovered from the travel agents as per credit terms allowed. Commission paid to travel agents should be checked by reference to the agreement on that behalf.
 - (i) Apart from control over stock of edibles, control over issue and physical stock of linen crockery, cutlery, glassware, silver, toilet items, etc. should be verified.
 - (j) The auditor should verify the restaurant bills with reference to KOT (Kitchen order Ticket).
 - (k) The auditor should ensure that all taxes have been included in the client's bills.
 - (l) Computation and payment of salaries and wages vis-a-vis number of employees must be checked.

11.3 AUDIT OF EDUCATIONAL INSTITUTIONS

The special steps involved in the audit of an educational institution are the following:

- (i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.
- (ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- (iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test check amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- (iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.

- (v) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- (vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
- (vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
- (viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.
- (ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
- (x) Verify rental income from landed property with the rent rolls, etc.
- (xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- (xii) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
- (xiii) Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.
- (xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.
- (xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- (xvi) Verify that the Provident Fund money of the staff has been invested in appropriate securities.
- (xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- (xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- (xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.
- (xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
- (xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
- (xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.
- (xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- (xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.



11.4 AUDIT OF CO-OPERATIVE SOCIETIES

Section 17 (2) of the Co-operative Societies Act, 1912 specifically requires the auditor to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society. The auditor of a co-operative society is also required to point out various irregularities, improprieties, and departures from the provisions of the Act, rules framed thereunder, and the bye-laws of the society.

The special features of co-operative societies audit, to be borne in mind while conducting the audit are as follows:

1. **Examination of overdue debts:** Overdue debts for a period from six months to five years and more than five years will have to be classified and shall have to be reported by an auditor. It affects its working capital position. They will have to be classified as good or bad. The auditor will have to ascertain whether proper provisions for doubtful debts is made and whether the same is satisfactory. The percentage of overdue debts to the working capital and loans advanced will have to be compared with last year, so as to see whether the trend is increasing or decreasing whether due and proper actions for recovery are taken, the position regarding cases in co-operative courts, District Courts etc. and the results thereof.
2. **Overdue Interest:** Overdue interest should be excluded from interest outstanding and accrued due while calculating profit. Overdue interest is interest accrued or accruing in accounts, the amount of which the principal is overdue.
3. **Certification of Bad Debts:** Bad debts and irrecoverable losses before being written off against Bad Debts Funds, Reserve Fund etc. should be certified as bad debts or irrecoverable losses by the auditor where the law so requires. Where no such requirement exists, the managing committee of the society must authorise the write-off.
4. **Valuation of Assets and Liabilities:** Regarding valuation of assets there are no specific provisions or instructions under the Act and Rules and as such due regard shall be had to the general principles of accounting and auditing conventions and standards adopted. The auditor will have to ascertain existence, ownership and valuation of assets. Fixed assets should be valued at cost less adequate provision for depreciation. The incidental expenses incurred in the acquisition and the installation expenses of assets should be properly capitalised. If the difference in the original cost of acquisition and the present market price is of far reaching significance, a note regarding the present market value may be appended; so as to have a proper disclosure in the light of present inflationary conditions. The current assets be valued at cost or market price, whichever is lower. Regarding the liabilities, the auditor should see that all the known liabilities are brought into the account, and the contingent liabilities are stated by way of a note.
5. **Adherence to Co-operative Principles:** The auditor will have to ascertain in general, how far the objects, for which the co-operative organisation is set up, have been achieved in the course of its working. While auditing the expenses, the auditor should see that they are economically incurred and there is no wastage of funds. Middlemen commissions are, as far as possible, avoided and the purchases are made by the committee members directly from the wholesalers. The principles of propriety audit should be followed for the purpose.
6. **Observations of the Provisions of the Act and Rules:** An auditor of a co-operative society is required to point out the infringement with the provisions of Co-operative Societies Act and Rules and bye-laws. The financial implications of such infringements should be properly assessed by the auditor and they should be reported. Some of the State Acts contain restrictions on payment of dividends, which should be noted by the auditor.
7. **Verification of Members' Register and examination of their pass books:** Examination of entries in members, pass books regarding the loan given and its repayments, and confirmation of loan balances in person is very much important in a co-operative organisation to assure that the entries in the books of accounts are free from manipulation.

8. **Special report to the Registrar:** During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society, he may report these special matters to the Registrar, drawing his specific attention such irregularities. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance a special report may become necessary:
 - (i) Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.
 - (ii) Detection of fraud relating to expenses, purchases, property and stores of the society.
 - (iii) Specific examples of mis-management including decisions of management against co-operative principles.
 - (iv) In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.
9. **Audit classification of society:** After a judgment of an overall performance of the society, the auditor has to award a class to the society. This judgment is to be based on the criteria specified by the Registrar. It may be noted here that if the management of the society is not satisfied about the award of audit class, it can make an appeal to the Registrar, and the Registrar may direct to review the audit classification. The auditor should be very careful, while making a decision about the class of society.

11.5 AUDIT OF SELF-HELP GROUPS

Self Help Group (SHG) Movement in India has been recognized as an effective strategy for mobilization and empowerment of rural people, particularly poor women and other marginalized groups. In India, Self Help Groups or SHGs represent a unique approach to financial intermediation. The approach combines access to low-cost financial services involving a process of self-management, with an objective of social and economic development for the women SHG members. Formations of SHGs are facilitated by the Government or by NGOs. SHGs are linked not only to banks but also to wider development programmes, SHGs are seen to confer many benefits, both economic and social.

As expert accounting professionals are hardly available at Gram Panchayat level, the need of the hour is "Community Audit" and it is necessary to develop sufficient number of "Community Auditors" for the sake of financial transparency.

The Institute & WBSRLM have entered into a MOU to enable undertaking of various collaborative activities for establishing "Community Audit" system for Self Help Groups in West Bengal by developing sufficient number of quality "Community Auditors" for meeting the audit needs of SHGs in the state.

Applying the Field Balance Sheet Approach to Audit:

1. **Background Review:** During a background review, a preliminary examination of the group level records, including the cash book, is conducted. The auditor also does a general review of the group level records and member passbooks to verify/ cross-check data entries for their accuracy and correct posting.
2. **Prepare Field Balance Sheet:**

The auditor prepares the Field Balance Sheet for the group, as on the date of the audit, based on the SHG's internal records and then cross checks the correctness of balance sheet items. The primary objective is to ascertain the retained earnings of the SHG.



Sl. No.	Assets	Amount	Sl. No.	Liabilities	Amount
1	Cash in Hand		1	Voluntary Saving	
2	Cash at Bank		2	External loan Outstanding	
3	Loan Outstanding with members		3	Equity:	
4	Fixed Deposit		a	Compulsory saving	
5	Fixed Asset		b	Retained Earning	
	Total				

http://www.microsave.net/files/pdf/IFN_54_SHG_Audit_A_Field_Balancing_Approach.pdf

- 3. Private Meetings with Members:** The auditor conducts private interviews with 25% of total members to triangulate information collected from the background review, as well as from the Field Balance Sheet and to ascertain the decision-making pattern in the group.
- 4. Meeting with the SHG Group (30minutes):** If serious issues were raised during the course of the audit, the auditor will meet with the entire group for further discussion.
- 5. Reporting:** Once the auditing is complete, the auditor summarises any weak practices that put savings at risk or make records unreliable, and recommends any better methods. S/he submits the Field Balance Sheet, along with a summary report to the MFI/bank, to all group members and adds relevant comments to enable decision making regarding provision of credit.

11.6 AUDIT OF NON-GOVERNMENTAL ORGANISATIONS (NGOs)

Audit Procedure for Conducting the Audit of Non-Governmental Organisation NGO's can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives.

Non-Governmental Organisations are generally incorporated as societies under the Societies Registration, Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGO's can also be incorporated as a company under section 8 of the Companies Act, 2013.

While planning the audit of a Non-Governmental Organisation (NGO), the auditor may concentrate on the following;

- Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.
- Reviewing the legal form of the organisation and its Memorandum of Association, Articles of Association, rules and Regulations.
- Reviewing the NGO's Organisation chart, Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and Formats, budgetary policies, if any.
- Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.

The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material is omitted:

- (i) **Corpus fund** :The contributions/grants received towards corpus be vouched with reference to the letters from the donor(s). The interest income be checked with investment Register and physical investments in hand.
- (ii) **Reserves** : Vouch transfers from projects/programmes with donors letters and board resolutions of NGO. Also check transfers and adjustments made during the year.
- (iii) **Ear-marked Funds** : Check requirements of donors' institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
- (iv) **Project/Agency Balances**: Vouch disbursements and expenditures as per agreements with donors for each of the balances.
- (v) **Loans** : Vouch loans with loan agreements receipt counter –foil issued.
- (vi) **Fixed Assets** : Vouch all acquisitions/sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/agreements for the grants. For immovable property, check title, etc.
- (vii) **Investments** : Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis-investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
- (viii) **Cash in Hand** : Physically verify the cash in hand and imprest balance, at the close of the year and whether it tallies with the books of accounts.
- (ix) **Bank Balance** : Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.
- (x) **Stock in Hand** : Verify stock in hand and obtain certificate from the management for the quantities and valuation of the same.
- (xi) **Programme and Project Expenses** : Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.
- (xii) **Establishment Expenses**: Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.

The receipt of income of NGO may be checked on the following lines:

- (i) **Contribution and Grants for projects and programmes**: Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
- (ii) **Receipts from Fund arising programmes**: Verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.
- (iii) **Membership Fees**: Check fees received with membership register, ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.
- (iv) **Subscription** : Check with subscription register and receipts issued. Reconcile subscription received with printing and despatch of corresponding magazine/circulars/periodicals. Check the receipts with subscription rate schedule.
- (v) **Interest and Dividends** : Check the interest and dividends received and receivable with investments held during the year.



11.7 AUDIT OF LOCAL BODIES

Local bodies are institutions of the local self governance, which look after the administration of an area or small community such as villages, towns, or cities. The Local bodies in India are broadly classified into two categories. The local bodies constituted for local planning, development and administration in the rural areas are referred as Rural Local Bodies (Panchayats) and the local bodies, which are constituted for local planning, development and administration in the urban areas are referred as Urban Local Bodies (Municipalities).

Article 243J of the Constitution states that the Legislature of a State may, by law, make provisions with respect to the maintenance of accounts by the Panchayats and the auditing of such accounts.

Article 243Z of the Constitution states about the audit of accounts of Municipalities. The Legislature of a State may, by law, make provisions with respect to the maintenance of accounts by the Municipalities and the auditing of such accounts .

Financial Administration of Local Bodies.

Salient Features of Financial Administration of Local Bodies

- (i) **Budgetary Procedure:** The objective of local bodies budgetary procedure are financial accountability, control of expenditure, and to ensure that funds are raised and moneys are spent by the executive departments in accordance with the rules and regulations and within the limits of sanction and authorisation by the legislature or Council. Different aspects covered in budgeting are determining the level of taxation, fees, rates, and laying down the ceiling on expenditure, under revenue and capital heads.
- (ii) **Expenditure Control:** At the State and Central level, there is a clear demarcation between the legislature and executive. In the local body, legislative powers are vested in the Council whereas executive powers are delegated to the officers, e.g., Commissioners. All matters of regular revenue and expenditures are generally delegated to the executive wing. For special situations like, reduction in property taxes, refund of security deposits, etc., sanction from the legislative wing is necessary.
- (iii) **Accounting System:** Municipal Accounting System has been conventionally prepared under the cash system. In the recent past however, it is being changed to the accrual system of accounting. The accounting system is characterised by
 - (a) subsidiary and statistical registers for taxes, assets, cheques etc.,
 - (b) separate vouchers for each type of transaction,
 - (c) compulsory monthly bank reconciliation,
 - (d) submission of summary reports on periodical basis to different authorities at regional and state level.

The objective of audit are:

- To report the content and presentation of financial statements are true and fair
- Detection and prevention of error fraud, misuse of funds
- To ascertain that full value received for money spent
- Legal and administrative requirements fulfilled

The audit programme for local bodies include the following:

- All sanctions are accorded by competent authority
- Expenditure incurred are according to provisions and as per regulations framed by competent authority
- Different schemes, programmes, and projects are running economically and the purpose such programme is achieved.

11.8 GOVERNMENT EXPENDITURE AUDIT

(a) Government Expenditure Audit

Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below:

- (i) **Audit against Rules & Orders:** The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
- (ii) **Audit of Sanctions:** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
- (iii) **Audit against Provision of Funds:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
- (iv) **Propriety Audit:** It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor aims to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.
- (v) **Performance Audit:** This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

(b) Role of C&AG in the Audit of a Government company:

The auditor of a government company is appointed by the C&AG.

The C&AG have powers under section 143 of the Companies Act, 2013 as follows:

- (i) to direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as such;
- (ii) to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorise in this behalf; and for the purposes of such audit, to require information or additional information to be furnished to person or persons so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may, by general or special order; direct.

In addition, the C&AG has a right to comment upon or supplement the audit report in such manner as he thinks fit.



11.9 PROPRIETY AUDIT IN THE CONTEXT OF GOVERNMENT AUDIT

Propriety Audit: Under 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. However, some general principles have been laid down in the Audit Code, which have for long been recognized as standards of financial propriety. Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

1. The expenditure should not be prima facie more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
2. No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
3. Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
 - (i) the amount of expenditure involved is insignificant; or
 - (ii) a claim for the amount could be enforced in a Court of law; or
 - (iii) the expenditure is in pursuance of a recognised policy or custom; and
 - (iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

11.10 AUDIT OF COMMERCIAL ACCOUNTS

The government also engages in commercial activities and for the purpose it may incorporate following types of entities:

- (i) Departmental enterprises engaged in commercial and trading operations, which are governed by the same regulations as other Government departments such as defense factories, mints, etc.
- (ii) Statutory corporations created by specific statutes such as LIC, Air India, etc.
- (iii) Government companies, set up under the Companies Act, 2013. All aforesaid entities are required to maintain accounts on commercial basis. The audit of departmental entities is done in the same manner as any Government department, where commercial accounts are kept. Audit of statutory corporations depends on the nature of the statute governing the corporation. In respect of government companies, the relevant provisions of Companies Act, 2013 are applicable.

Study Note - 12

CASE STUDY ON PERFORMANCE ANALYSIS



This Study Note includes

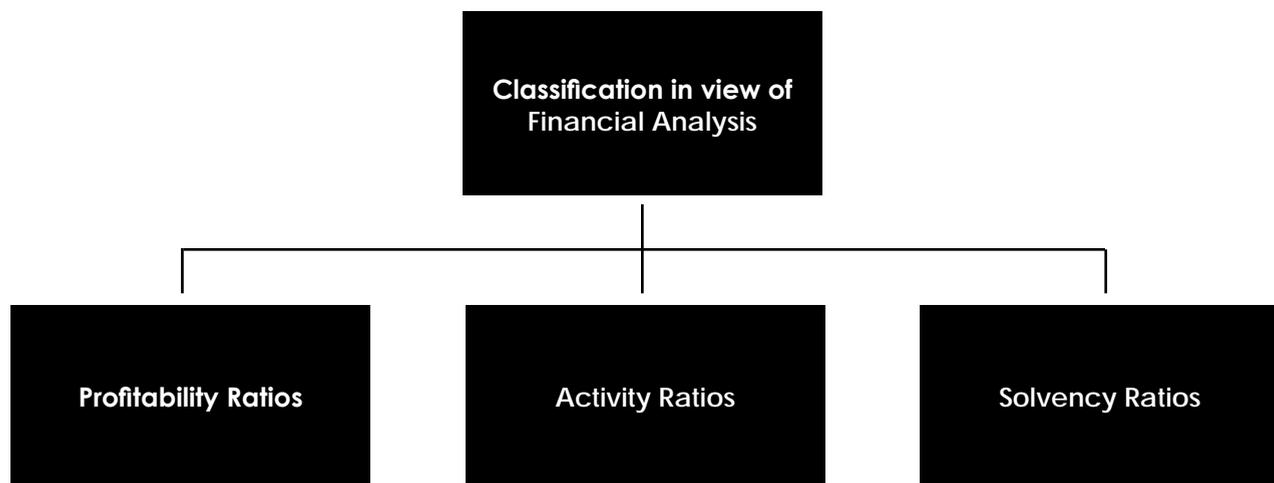
- 12.1 Application of Ratios for Assessment of Performance
- 12.2 Waste Multiplier
- 12.3 Utilities Consumption
- 12.4 Capacity Determination and Utilisation
- 12.5 Value Addition
- 12.6 Inventory Valuation
- 12.7 Abnormal Events such as Strike, Lock-out and other factors
- 12.8 Profitability Analysis**
- 12.9 Reconciliations of Financial and Cost Records

12.1 APPLICATION OF RATIOS FOR ASSESSMENT OF PERFORMANCE

Accounting ratios are relationships expressed in mathematical terms between figures which are connected with each other in some manner. Obviously, no purpose will be served by comparing two sets of figures which are not at all connected with each other. Over the past few years, financial ratios have been subjected to empirical analysis to find their other uses.

CLASSIFICATION OF RATIOS:

Ratios can be classified as:



Profitability Ratios:

(A) In Relation to Sales

1. Gross profit Ratio
2. Operating Ratio
3. Operating Profit Ratio
4. Net Profit Ratio
5. Expense Ratio

(B) In Relation to Investment

1. Return on Investment
2. Return on Equity Shareholders Fund
3. Return on Total Resources

Activity Ratios:

1. Inventory Turnover Ratio
2. Debtors Turnover Ratio
3. Creditors Turnover Ratio
4. Fixed Assets Turnover Ratio
5. Working Capital Turnover Ratio
6. Capital Turnover Ratio

Solvency Ratios:

A. Long Term Solvency Ratios

1. Debt Equity Ratio
2. Proprietary Ratio
3. Fixed Assets Ratio
4. Capital Gearing Ratio

B. Short Term Solvency Ratios

1. Current Ratio
2. Liquidity Ratio
3. Interest Coverage Ratio
4. Absolute Liquid Ratio

Let us now go through some illustrations:

Financial Position and Ratio Analysis forms part of Part D of the Annexure to Cost Audit Report.



Illustration 1.

The Balance Sheet of X Ltd. stood as follows as on:

(Rupees in Lakhs)

Liabilities	31 March 2016	31 March 2015	Assets	31 March 2016	31 March 2015
Capital	1,500	1,500	Fixed Assets	2,400	1,800
Reserves	696	600	Less: Depreciation	840	600
Loans	600	720	Net Fixed Assets	1,560	1,200
Creditors & Others			Investment	240	180
Current Liabilities	774	150	Stock	720	600
			Debtors	420	300
			Cash & Bank	120	120
			Other Current assets	150	150
			Miscellaneous Expenditure	360	420
	3,570	2,970		3,570	2,970

You are given the following information for the year 2015-16:

(Rupees in Lakhs)

Sales	3,600
Profit before Interest & Tax	900
Interest	144
Provision for Tax	360
Proposed Dividend	300

Required:

- (i) Calculate for the year 2015-16:
 - A. Return on Capital Employed.
 - B. Stock Turnover Ratio.
 - C. Return on Net Worth.
 - D. Current Ratio.
 - E. Proprietary Ratio

Answer:

(A) Computation of Capital Employed –

	2016	2015
Fixed Assets	2,400	1,800
Less: Depreciation	840	600
	1,560	1,200
Current Assets		
Stock	720	600
Debtors	420	300
Cash & Bank	120	120
Other current assets	150	150
	1,410	1,170
Current Liability	774	150

Working capital	636	1,020
Net Fixed Assets + Working Capital	2,196	2,220

Average Capital Employed = $(2,196 + 2,220)/2 = 2,208$

Total Earning = Profit after tax + Interest on debt funds + Non-Operating Adjustments
 = $(900 - 144 - 360) + 144$
 = 540

$$\therefore \text{Return on Capital Employed} = \frac{\text{Total Earning}}{\text{Average Capital Employed}}$$

$$= \frac{540}{2,208} \times 100 = 24.46\%$$

Alternative Method of Computation of Capital Employed

Capital Employed means average of net fixed assets (excluding effect of revaluation of fixed assets) plus non-current investments and net current assets existing at the beginning and close of the financial year.

Particulars	2016	2015
Opening Net Fixed Assets	1200	Info. Not Available
Closing Net Fixed Assets	1,560	1200
Average Net Fixed Assets (1)	1,380	

Particulars	2016	2015
Opening Non-Current Investments	0	0
Closing Non-Current Investments	0	0
Average Non-Current Investments (2)	0	0

Particulars	2016	2015
Opening Net-Current Assets	1,020	Info. Not Available
Closing Net-Current Assets	636	1,170
Average Net-Current Assets (3)	828	

Capital Employed (1+2+3)	2,208	
---------------------------------	--------------	--

Notes to the Computation of Capital Employed

1. Current Assets includes Stock, Debtors, Cash and Other Current Assets
2. Assumed that the Investments in Balance sheet are Non-Current Investments
3. Refer Financial Statements of 2014-15 for the ' Info. Not Available'



It is normally expressed as a percentage. It indicates the rate of return earned by an enterprise from its total Capital Employed in the business. It is also an indicator of the profit earning capacity of an enterprise. A higher return reveals a better profitability on the total Capital Employed in the business.

$$\begin{aligned} \text{(B) Computation of Stock Turnover Ratio} &= \frac{\text{Net sales Excluding Excise Duty \& Sales Tax}}{\text{Average Stock}} \\ &= \frac{3,600}{(720 + 600)/2} = 5.45 \text{ times} \end{aligned}$$

This ratio indicates the movement of stock during a particular period. In other words, it indicates how fast goods are sold out from the stock of those goods. Higher ratio indicates a faster movement of stock.

$$\text{(C) Return on Net Worth} = \frac{\text{Total Earning}}{\text{Average Net Worth}}$$

In this formula, The word 'Average' is to be deleted because of the following.

As per Section 2(57) of Companies Act 2013, "Net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

Net Worth = Share Capital + Reserve & Surplus – Revaluation reserve – ~~Intangible assets~~ – Accumulated losses, if any

$$\text{Net Worth} = 1,500 + 696 - 360 = 1,836$$

$$\text{Return on Net Worth} = \frac{540}{1,836} = 29.41\%$$

It is normally expressed as a percentage. It indicates the rate of return earned by an enterprise on the capital invested by its owners. This is an indicator of the rate of return on the shareholders' fund invested in the business. A higher return reveals the better profitability to the shareholders' of the enterprise.

$$\text{(D) Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$\text{Current Ratio} = \frac{1,410}{774} = 1.82$$

This ratio indicates whether an enterprise possesses sufficient Current Assets to pay off its Current Liabilities. This ratio is an indicator of short term solvency or liquidity position of an enterprise. Ideal ratio is 2:1, i.e., the enterprise should have twice the current assets than the current liabilities, to exhibit ideal short term solvency position.

$$\text{(E) Proprietary Ratio} = \frac{\text{Proprietary Funds}}{\text{Total Assets}}$$

$$\begin{aligned} \text{Proprietary Ratio} &= \text{Equity Share Capital} + \text{Preference Share Capital} + \text{reserve \& Surplus} - \text{Accumulated Losses} \\ &= 1,500 + 696 - 360 = 1,836 \end{aligned}$$

Total Assets = Net Fixed assets + Total Current Assets (Only tangible assets will be included)
 = 1,560 + 1,410 = 2,970

Proprietary Ratio = $\frac{1,836}{2,970} \times 100 = 61.82\%$

This ratio indicates the portion of Proprietors' Fund or Shareholders' fund invested in Fixed Assets. It is also an indicator of the efficiency of the management regarding the formulation of the financial planning.

Illustration 2.

From the following figures extracted from the financial and cost accounting records, you are required to compute:

- (i) Value Added.
- (ii) Ratio of Operating Profit to Sales.
- (iii) Ratio of Operating Profit to Value Added.

Particulars	₹ in lakhs
Net Sales excluding Excise Duty	42,000
Increase in Stock of finished goods	500
Expenses:	
Raw Materials consumed	8,600
Packing materials consumed	2,560
Stores and spares consumed	1,120
Power and fuel	9,200
Insurance	240
Direct salaries and wages	960
Depreciation	1,770
Interest paid	2,796
Factory overhead:	
Salaries and wages	480
Others	500
Selling and distribution expenses:	
Salaries and wages	240
Additional sales tax	914
Administration overheads:	
Salaries and wages	240



Answer :

	₹ in lakhs	₹ in lakhs
(i) Computation of Value Added		
Net Sales+ Increase in Stock of Finished Goods		42,500
Less:		
Cost of bought out materials and services:		
Raw Materials –	8,600	
Packing Materials	2,560	
Stores and Spares	1,120	
Power and fuel	9,200	
Insurance	240	
Other factory overhead	500	22,220
Value Added		20,280
Composition of Value Added:		
Depreciation) (Company as retained funds)	1,770	
Interest	2,796	
Additional Sales tax	914	
Salaries and wages (960 + 480 + 240 + 240)	1,920	7,400
Profit before tax (balancing figure) (Company as retained funds)	12,880	
Operating Profit:(Company as retained funds)		
PBT		12,880
Interest paid		2,796
		15,676

(ii) Ratio of operating profit to net sales = $\frac{\text{Operating profit}}{\text{Net sale}} = \frac{15,676}{42,000} \times 100 = 37.32 \%$

(iii) Ratio of operating profit to value added = $\frac{\text{Operating profit}}{\text{Value Added}} = \frac{15,676}{20,280} \times 100 = 77.30 \%$

Illustration 3.

M Ltd has the following Balance Sheets as on 31 March 2016 and 31 March 2015:

Particulars	₹ in lakhs	
	31 March 2016	31 March 2015
Sources of Funds:		
Shareholder's Fund	4,954	3,144
Loan Funds	7,340	6,366
	12,294	9,510
Applications of Funds:		
Fixed Assets	7,132	6,000
Cash & Bank	1,178	1,140
Debtors	3,190	2,536
Stock	5,934	5,014
Other Current Assets	3,334	3,008
Less: Current Liabilities	(8,074)	(7,788)
	12,694	9,910

The Income Statement of the M Ltd for the year that ended is as follows:

	₹ in lakhs	
	31 March 2016	31 March 2015
Sales	44,530	27,964
Less: CGS	41,920	25,288
GP	2,610	2,676
Less: Selling, General & Administrative Expenses	2,070	1,304
Earnings before Interest and Tax (EBIT)	540	1,372
Less: Interest Expense	226	210
Profit before tax	314	1,162
Less: Tax	46	384
Profit after Tax	268	778

Required:

- (i) Calculate for the year 2015-16
 - a. Inventory Turnover Ratio
 - b. Return on Net worth
 - c. ROI
 - d. ROE
 - e. Profitability ratio
- (ii) Give a brief comment on the financial position of M Ltd.

Answer:

(i) a. Inventory Turnover Ratio (for the year 2015-16) = $\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}} = \frac{41,920}{5,474} = 7.66$

b. Return on Net Worth (for the year 2015-16) = $\frac{\text{Profit after tax}}{\text{Net Worth}} = \frac{268}{4,954} \times 100 = 5.41\%$
 Net Worth = Shareholder's Fund

ROI (for the year 2015-16) = $\frac{\text{Net Profit before Interest but after tax}}{\text{Average Capital Employed}} \times 100$
 $= \frac{494}{11,302} \times 100 = 4.37\%$

Net Profit before interest but after tax = 268 + 226 = 494

Average Capital Employed = Average of Opening and closing of Net Current Assets + Average of Opening and closing of Net Fixed Assets

= (12,694 + 9,910) / 2 = 11,302

c. ROE (for the year 2015-16) = $\frac{\text{Net Profit available to Equity Shareholders}}{\text{Average Equity Shareholders' Fund}} \times 100$
 $= \frac{268}{(4,954 + 3,144) / 2} \times 100 = 6.62\%$



d. Profitability ratio (for the year 2015-16) –

$$(i) \quad \text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100 = \frac{2,610}{44,530} \times 100 = 5.86\%$$

$$(ii) \quad \text{Operating Profit Ratio} = \frac{\text{Operating Profit}}{\text{Sales}} \times 100 = \frac{314 + 226}{44,530} \times 100 = 1.21\%$$

$$(iii) \quad \text{Net Profit Ratio} = \frac{\text{Profit before tax}}{\text{Sales}} \times 100 = \frac{314}{44,530} \times 100 = 0.71\%$$

- (ii) Profitability of operation of the company remarkably decline from ₹1,372 (₹ in Lakhs) to ₹540 (₹ in Lakhs), due to a huge increase in the operating expenses during the year 2015-16. NP of the company also reduces due to an increase in the interest expenses. During the year 2015-16, both Fixed operating expenses as well as fixed financial expense have increased, as a consequence of which the NP of the company radically reduced. During 2015-16, both operating and Financial Leverages have become adverse, as a result of which the company has been crucially suffering from a liquidity crisis during the year 2015-16.

Illustration 4.

Following are the summarized accounts of Key Ltd and Pee Ltd for the 2 years 2014 and 2015:

Particulars	₹ in Lakhs			
	Key Ltd		Pee Ltd	
	2014	2015	2014	2015
Sales	5,412	4,575	1,752	1,447
Manufacturing & Other Expenses	5,104	4,356	1,496	1,182
Depreciation	56	51	60	35
Profit before Tax	252	168	196	230
	5,412	4,575	1,752	1,447
Miscellaneous Expenditure	165	169	-	-
Fixed Assets	836	941	351	275
Stock	1,124	1,219	177	226
Debtors	728	824	582	402
Bank	93	33	464	246
	2,946	3,186	1,574	1,149
Creditors	947	926	233	175
Taxation [Less Advance Tax]	56	68	87	58
Short-term Borrowings	424	800	464	216
Long-term Borrowings	254	210	10	-
Capital & Reserves	1,265	1,182	780	700
	2,946	3,186	1,574	1,149

You are required to:

- Indicate and calculate five Ratios which in your opinion are relevant in determining the stability of the two companies.
- Compare the Ratios so determined for the two companies. Indicate what conclusions can be drawn therefrom?

Answer:

In our opinion, the following five Ratios are very much relevant in determining the stability of the given two companies as growing concerns:

Computation of five Relevant Ratios in determining the stability of two companies

	Key Ltd		Pee Ltd	
	2014	2015	2014	2015
(i) Current Ratio $\frac{CAs}{CLs}$	1,945 ÷ 1,427 = 1.36	2,076 ÷ 1,794 = 1.16	1,223 ÷ 784 = 1.56	874 ÷ 449 = 1.95
(ii) Total Debts to Net Worth $\left[\frac{\text{Total Outside Liabilities}}{\text{Net Worth}} \right]$	1,681 ÷ 1,100 = 1.528	2,004 ÷ 1,013 = 1.978	794 ÷ 780 = 1.017	449 ÷ 700 = 0.641
(iii) Total Asset Turnover ratio $\left[\frac{\text{Turnover}}{\text{Total Assets}} \right]$	5,412 ÷ 2,781 = 1.946	4,575 ÷ 3,017 = 1.516	1,752 ÷ 1,574 = 1.113	1,449 ÷ 1,149 = 1.259
(iv) ROI $\left[\frac{PBT}{\text{Total Assets}} \times 100 \right]$	252 ÷ 2,781 = 0.090	168 ÷ 3,017 = 0.055	196 ÷ 1,574 = 0.124	230 ÷ 1,149 = 0.20
(v) Liquid Assets to Operating Expenses [excluding Depreciation] per day	821 ÷ 13.98 = 59	857 ÷ 11.90 = 72	1,046 ÷ 4.09 = 256	648 ÷ 3.23 = 201

From the different Ratios as calculated in (i) above, it has been observed that the results of Pee Ltd for the year 2015 were better than that of Key Ltd. for 2014. On the other hand, the results of Key Ltd. for the year 2015 were weaker than that of for 2014. Short-term liquidity of solvency Ratios (i.e., Current Ratio and Liquid Assets to Operating-expenses Ratio) of Pee Ltd were improved in 2015 than 2014, whereas these Ratios of Key Ltd were deteriorated in 2015 than it was in 2014. Pee Ltd had improved its long-term solvency Ratios (i.e., Total debts to Net Worth and Total Asset Turnover Ratio) in 2015 than in 2014, whereas these Ratios were also deteriorated in 2015 than in 2014 in the case of Key Ltd. As far as profitability was concerned, Pee Ltd had remarkably increased its ROI in 2015 than it was in 2014, whereas ROI of Key Ltd was remarkably declined in 2015 than 2014.

Therefore, Ratios as computed in the above as showing as stronger position in 2015 as compared to 2014 in the case of Pee Ltd, whereas they are showing deterioration position in 2015 as compared to 2014 in the case of Key Ltd.

Working Notes:

₹ In Lakhs

1. Net Worth	Key Ltd		Pee Ltd	
	2014	2015	2014	2015
Capital & Reserves	1265	1182	780	700
Less : Miscellaneous Expenditure	165	169	000	000
Net Worth	1100	1013	780	700

2. Total Outside Liabilities	Key Ltd		Pee Ltd	
	2014	2015	2014	2015
Long-term Borrowings	254	210	10	-
Short-term Borrowings	424	800	464	216
Creditors	947	926	233	175
Taxation [Less: Advance Tax]	56	68	87	58
Total Outside Liabilities	1681	2004	794	449



3. Current Assets	Key Ltd		Pee Ltd	
	2014	2015	2014	2015
Stock	1124	1219	177	226
Debtors	728	825	582	402
Bank	93	33	464	246
Current Assets	1945	2076	1223	874

4. Current Liabilities	Key Ltd		Pee Ltd	
	2014	2015	2014	2015
Creditors	947	926	233	175
Taxation [Less: Advance Tax]	56	68	87	58
Short-term Borrowings	424	800	464	216
Current Liabilities	1427	1994	784	449

5. Total Assets	Key Ltd		Pee Ltd	
	2014	2015	2014	2015
Fixed Assets	836	941	351	275
Current Assets [as computed in (3) above]	1945	2076	1223	874
Total Assets	2781	3017	1574	1149

6. Liquid Assets	Key Ltd		Pee Ltd	
	2014	2015	2014	2015
Current Assets [as computed in (3) above]	1945	2076	1223	874
Less: Stock	1124	1219	177	226
Liquid Assets	821	857	1046	648

7. Operating Expenses (excluding Depreciation) per day	Key Ltd		Pee Ltd	
	2014	2015	2014	2015
	5104/365	4356/366	1496/365	1182/365
	=13.98	= 11.90	= 4.09	= 3.23

Illustration 5.

The Balance Sheets of SLtd for the last 3 years read as follows:

₹ in lakhs

	As on 31 March 2014	As on 31 March 2015	As on 31 March 2016
Sources of Fund:			
Share Capital [Share of ₹10 each]	2,200	2,200	3,200
Securities Premium	1,900	2,000	700
Reserves [After 10% Dividend]	1,900	2,100	1,900
Long-term Loan	1,750	1,550	2,600
Total Funds	7,750	7,850	8,400
Represented by:			
Fixed Assets	2,800	3,200	3,500
Less: Depreciation	800	1,050	1,300
	2,000	2,150	2,200
Capital WIP [work-in-progress]	1,000	1,100	1,200
Investment	600	700	650
A.	3,600	3,950	4,050
Net Current Assets:			
Current Assets:			
Debtors	1,800	1,950	2,150
Stock	1,900	2,050	2,700
Cash & Bank	800	800	800
Others	550	750	1,800
	5,050	5,550	7,450
Less: Current Liabilities	900	1,650	3,100
B.	4,150	3,900	4,350
Total Assets [A+B]	7,750	7,850	8,400
Sales [excluding Excise Duty and Sales Tax @ 20%]	4,050	4,200	5,400

- I. Calculate & analyse for the year 2014-15 and 2015-16:
 - i. Fixed Asset Turnover Ratio
 - ii. Stock Turnover Ratio
 - iii. Debtors' 'Turnover Ratio in terms of number of days'
 - iv. Debt-Equity Ratio
 - v. Current assets to current liability
- II. Briefly comment on the performance of the company.



Answer:

Calculation of ration for the year 2014-15& 2015-16

	2014-15	2015-16
(i) Fixed Asset Turnover Ratio $\frac{\text{Net sales excluding Excise Duty \& Sales Tax}}{\text{Average Fixed Asset}}$	$\frac{4,200}{2,075} = 2.02$ times	$\frac{5,400}{2,175} = 2.48$ times
(ii) Stock Turnover Ratio $\frac{\text{Net sales excluding Excise Duty \& Sales Tax}}{\text{Average Stock}}$	$\frac{4,200}{1,975} = 2.13$ times	$\frac{5,400}{2,375} = 2.27$ times
(iii) Debtors' Turnover Ratio [in term of no. of days' sales $\frac{\text{Average Receivables}}{\text{Credit Sales including Excise duty and Sales Tax}} \times \text{No. of days in the year}$	$\frac{1,875}{5,040} \times 365 = 136$ days	$\frac{2,050}{6,480} \times 365 = 115$ days
(iv) Debt-Equity Ratio $\frac{\text{Debt}}{\text{Equity}}$	1,550/ 6,300 =0.25	2,600/ 5,800 = 0.45
(v) Current Ratio = Current Assets/ Current liability	5,550/1,650 = 3.36	7,450/3,100 = 2.40

Comments on the performance of the company:

Fixed Asset Turnover Ratio indicates the level of efficiency of uses or utilizations of Fixed Assets. Here, this Ratio has increased in the year 2015-16 as compared to that of in 2014-15, and, thus, shows a better efficient use or utilization in Fixed Assets in the year 2015-16.

Stock Turnover Ratio is an indicator of the movement of stock. Higher Ratio indicates a faster movement of stock. Here, this Ratio has increased in 2015-16 as compared to that of in 2014-15, and, thus, shows a faster movement of stock in 2015-16 than in 2014-15. Yet, the inventory-holding period of the company is still high. Therefore, this Ratio should be compared with the industry average to draw a final conclusion about the efficiency of the inventory management of the company.

Debt Collection Period indicates the efficiency of the collection department as regards to the collection of credit sales. Here, the Debt Collection Period in 2015-16 is shorter that of in 2014-15, and, thus, reflects a more efficient collection process in 2015-16 than in 2014-15. But, to draw a final conclusion about the efficiency of debtors' management of the company, this Ratio should be compared with the industry average and the credit period received by the company from its creditors.

Debt-Equity Ratio indicates the proportion of debt Capital and Owners' Capital included in the Capital Structure. This is an indicator of the Capital Structure of an enterprise. It also shows the efficiency of the management in financial planning. The ideal ratio is 1:2.

Current ratio indicates whether an enterprise possesses sufficient Current Assets to pay off its Current liabilities. This ratio is an indicator of short-term solvency or liquidity position of an enterprise. Ideal ratio is 2:1.

Working Notes

1. Calculation of Sales including Excise Duty and Sales Tax

	2014-15	2015-16
	₹ in Lakhs	₹ in Lakhs
Sales Excluding Excise Duty and Sales Tax	4,200	5,400
Add: 20% Excise duty and Sales Tax	840	1,080
Sales including Excise Duty & Sales Tax	5,040	6,480

Note: While calculating the Fixed Asset Turnover Ratio and Stock Turnover Ratio, sales excluding excise duty & sales tax is considered. But, while calculating Debtors' Turnover Ratio, sales including excise duty and sales tax is considered as sales to debtors include excise duty and sales tax.

2. Calculation of Average Fixed Asset (Net)

In 2014 -15:

$$\text{Average Fixed Assets (Net)} = (2,000 + 2,150)/2 = ₹2,075 \text{ lakhs}$$

In 2015 – 16:

$$\text{Average Fixed Assets (Net)} = (2,150 + 2,200)/2 = ₹2,175 \text{ lakhs}$$

3. Calculation of Average Stock

In 2014 – 15:

$$\text{Average Stock} = (1,900 + 2,050)/2 = ₹ 1,975 \text{ lakhs}$$

In 2015 – 16:

$$\text{Average Stock} = (2,050 + 2,700)/2 = ₹2,375 \text{ lakhs}$$

4. Calculation of Average Receivables

In 2014-15

$$\text{Average Receivables} = (1,800 + 1,950)/2 = ₹1,875 \text{ lakhs}$$

In 2015-16

$$\text{Average Receivable} = (1,950 + 2,150)/2 = ₹ 2,050 \text{ lakhs}$$

5. Debtors' Turnover Ratio in term of number of days

$$\text{We know, Debtors' Turnover Ratio} = \frac{\text{Credit sales}}{\text{Average Receivables}}$$

Here, Debtors' Turnover Ratio in terms of number of days = Average Collection Period

$$= \frac{\text{No. of days in a year}}{\text{Debtors turnover Ratio}} = \frac{\text{No. of days in a year}}{\text{Credit sales} \div \text{Average Receivable}}$$

$$= \frac{\text{Average Receivables}}{\text{Credit Sales}} \times \text{No. of days in the year}$$

6. Debt/ Equity ratio

Debt = Long term loan

In 2014-15 = ₹ 1,550 lakhs

In 2015-16 = ₹ 2,600 lakhs

Equity = Equity share capital + Reserve & Surplus

In 2014-15 = 2,200 + 2,000 + 2,100 = ₹6,300 lakhs

In 2015 -16 = 3,200 + 700 + 1,900 = ₹5,800 lakhs



12.2 WASTE MULTIPLIER

In many continuous process industries cost data are arrived at with complexities in the calculation.

A Spinning unit of Cotton Textile Industry has a set of processing departments like Mixing and Blow Room, Carding, Drawing, Combing, Fly Frames and Ring Frames. Actually spinning unit comes under continuous process industry. Mixing and Blow Room are the starting point when the raw material cotton enters and comes out as yarn in the Ring Frame section. Obviously like every processing industry in spinning mills certain amount of wastage is emerging out of production in each and every department. It is segregated as usable waste and saleable waste apart from invisible loss. While the usable waste and saleable waste can be measured physically the invisible loss is found out from the input and output of raw materials after considering due weightage of usable and saleable waste. The actual waste which is extracted from the machine process depends upon the impurities in the cotton. The production process involving wastage has a routine or cycle.

For example the output of Blow Room goes to Carding and usable waste of Carding goes back to the cotton mix in Mixing and Blow Room and so on. The 'back' and 'forth' waste movement are given due consideration while calculating the raw material cost. The realization of saleable waste is given due credit in the cost of raw material consumed.

Waste multiplier is that quantity of output from any process, which will be needed to get one unit of final output.

Illustration 1.

The following are the process wise wastages on inputs in a Spinning Mill in the year 2015-16.

Process	% age of Wastages on Input
Blow Room	9.18
Carding	7.17
Drawing	1.10
Roving(Simplex)	0.30
Ring Frame(Spinning)	7.21
Reeling and Winding	1.50

From the above, calculate the process wise waste multiplier factor.

Answer:

Process	% age of wastages on input	Net output for 100 units of input	Waste multiplier
Total	-	100	1.3161
Blow Room	9.18	$100 - 9.18 = 90.82$	1.1953
Carding	7.17	$90.82 - 6.51 = 84.31$	1.1096
Drawing	1.10	$84.31 - 0.93 = 83.38$	1.0974
Roving(Simplex)	0.30	$83.38 - 0.25 = 83.13$	1.0941
Ring Frame(Spinning)	7.21	$83.13 - 5.99 = 77.14$	1.0153
Reeling and Winding	1.50	$77.14 - 1.16 = 75.98$	1.0000

Calculation = $1/75.98 = 0.013161$.

Illustration 2.

The following are the process-wise input and output in a Spinning Mill –

Blowroom :	Cotton processed Laps produced	4672563 kgs 4258274 kgs.
Carding :	Laps processed Silvers produced	4274362 kgs. 3976420 kgs.
Draw frames :	Silvers processed Silvers drawn	3948241 kgs. 3901810 kgs.
Roving (Simplex) :	Drawn silvers processed Transferred to Ring frame	3874125 kgs. 3831510 kgs.
Ring frame :	Silvers used Finished Yarn produced	3911645 kgs. 3641741 kgs.
Reeling and Winding :	Yarn wound Salable Yarn produced	3635420 kgs. 3580889 kgs.

Calculate the processwise Waste Multiplier factors.

Answer:

Process	Input (kgs)	Output (kgs) %	Loss (%)	Output (%)	Waste Multiplier
Total Consumption				100.00	1.3161
Blowroom :	4672563 kgs	4258274 kgs.	8.87	91.13	1.1994
Carding :	4274362 kgs.	3976420 kgs.	6.97	84.78	1.1158
Draw frames :	3948241 kgs.	3901810 kgs.	1.18	83.78	1.1026
Roving (Simplex) :	3874125 kgs.	3831510 kgs.	1.10	82.86	1.0905
Ring frame :	3911645 kgs.	3641741 kgs.	6.90	77.14	1.0153
Reeling and Winding :	3635420 kgs.	3580889 kgs.	1.50	75.98	1.0000

Loss Percentage = (Input-output)/input × 100

12.3 UTILITIES CONSUMPTION

The term 'Utilities' refer to significant inputs such as power, steam, water, compressed air and the like which are used for manufacturing process but do not form part of the final product. Broadband internet services (both fixed-line and mobile) are increasingly being included within the definition.

COST ACCOUNTING STANDARD – 8 (CAS-8) is issued by the Council of The Institute of Cost Accountants of India on "COST OF UTILITIES"

This standard deals with the principles and methods of classification, measurement and assignment of cost of utilities, for determination of the cost of product or service, and the presentation and disclosure in cost statements.

The objective of this standard is to bring uniformity and consistency in the principles and methods of determining the cost of utilities with reasonable accuracy.

Illustration 1.

X Ltd is having a business of generating Thermal Electricity. The company raises water from a lake nearby. The Water Collection Cost consists of water collected from lake and primary treatment. Thereafter the Water is transferred to Water Treatment Cost Centre for secondary treatment. The treatment water is further transferred to Water De-mineralization Cost Centre for power generation and to the Township for domestic use. Following information is provided for the respective cost centres.



Particulars	Cost Centres				
	UOM	Water Collection	Water treatment	De-mineralization	Township
Quantity of water raised / received	KL	4,00,000	3,80,000	2,60,000	1,00,000
Quantity Transferred	KL	3,80,000	3,60,000	2,55,000	-
Cost of Water raised	₹	4,00,000	-	-	-
Chemicals	₹	80,000	2,50,000	3,00,000	-
Salary	₹	3,00,000	2,50,000	3,00,000	-
Insurance	₹	50,000	40,000	50,000	-
Depreciation	₹	24,000	30,000	40,000	-
Repairs & Maintenance	₹	30,000	40,000	50,000	-
Total		8,84,000	6,10,000	7,40,000	-

Information about water quantity raised and lost in transfer.

Cost Centres	Quantity (KL)	
	Actual	Normal
From Water Collection to Water Treatment	20,000	15,000
From Water Treatment to De-mineralization	20,000	17,000
From Water treatment to Township	-	-
From De-mineralization to Power Generation	5,000	5,000
Total Loss	45,000	37,000
Quantity of water utilised	3,55,000	-
Total water Raised	4,00,000	-

1. Calculate the Cost of Water transferred from Water De-mineralization plant to Power Generation.
2. Calculate the total value of abnormal loss of water.
3. Present the information in Annexure to Cost Audit Report Part B, 2-B.

Answer:

Name of the Company: X Ltd.

Statement showing the Cost of water in Water Collection Cost Centre

Sl. No.	Particulars	Rate	Qty (KL)	Amount (₹)
1	Cost of water collected (₹)	1.00	4,00,000	4,00,000
2	Wages and Salaries (₹)			3,00,000
3	Consumables (Chemicals) (₹)			80,000
4	Repairs & Maintenance (₹)			30,000
5	Insurance (₹)			50,000
6	Depreciation (₹)			24,000
7	Others			-
8	Total Cost (₹) (1 to 8)	2.21	4,00,000	8,84,000
9	Rate (₹/KL)			2.21
10	Less - Abnormal loss	2.21	5,000	11,050
11	Total Cost of Water Collected (₹)	2.21	3,95,000	8,72,950
	Transfer of Collected water for Water Treatment	2.21	3,95,000	8,72,950

Note : The quantity of water transferred includes Normal water loss of 15,000 KL @ ₹ 2.21 i.e. ₹11,050

Statement showing the Cost of water in Water Treatment Cost Centre

Sl. No.	Particulars	Rate	Qty (KL)	Amount (₹)
1	Cost of Water received	2.21	3,95,000	8,72,950
2	Wages and Salaries (₹)			2,50,000
3	Consumables (Chemicals) (₹)			2,50,000
4	Repairs & Maintenance (₹)			40,000
5	Insurance (₹)			40,000
6	Depreciation (₹)			30,000
7	Total cost (₹) (1 to 8)	3.75	3,95,000	14,82,950
8	Rate (₹/KL)			3.75
9	Less - Abnormal loss	3.75	3,000	11,263
11	Total cost of Water Treated (₹) (7-9)	3.75	3,92,000	14,71,687
12	Transfer to Water De-mineralization	3.75	2,92,000	10,96,257
13	Transfer to Township	3.75	1,00,000	3,75,430

Note:

1. It is to be noticed that as per question, the Water Treatment received 2,60,000 KL of water that does not include any loss. Since, the normal loss of 22,000 KL i.e. (15,000 KL+17,000 KL) is to be included in consumption, the total water used for power generation sums up to 2,92,000 KL i.e. (2,60,000 KL + 15,000 KL + 17,000 KL)
2. The cost of water transfer to the Township is to be treated as Factory Overhead.

Statement showing the Cost of water in De-mineralization Cost Centre

Sl. No.	Particulars	Rate	Qty (KL)	Amount (₹)
1	Cost of Treated Water received	3.75	2,92,000	10,96,257
2	Wages and Salaries (₹)			3,00,000
3	Consumables (Chemicals) (₹)			3,00,000
4	Repairs & Maintenance (₹)			50,000
5	Insurance (₹)			50,000
6	Depreciation (₹)			40,000
7	Total cost (₹) (1 to 8)	6.29	2,92,000	18,36,257
8	Rate (₹/KL)			6.29
9	Less - Abnormal loss	6.29	-	-
10	Total Cost of Water De-mineralized and transferred for power generation (7-9)	6.29	2,92,000	18,36,257

Answer:

1. The cost of water transferred from De-mineralization plant to Power Generation is ₹ 18,36,257 i.e @ ₹ 6.29/KL.



2. The abnormal water losses are to be taken as Non-cost and shown in reconciliation statement.

Sl. No.	Cost Centre	Qty (KL)	Amount (₹)
1	Water Collection	5,000	11,050
2	Water Treatment	3,000	11,263
	Total	8,000	22,313

3. Name of the Company: X Ltd.

Part-B

2B. Details of Utilities Consumed

Name of Product		Thermal Electricity					
CETA heading		2716					
		Current Year			Previous Year		
Description of Material	UOM	Quantity	Rate per unit (₹)	Amount (₹)	Quantity	Rate per unit (₹)	Amount (₹)
Water - (De-mineralized)	KL	2,92,000	6.29	18,36,257	-	-	-
Total		2,92,000	6.29	18,36,257	-	-	-

Illustration 2.

SRIZONI LTD. of Gandhi Nagar producing industrial alcohol generates Bio-gas from the waste wash of alcohol in its Bio-gas Plant. The said Bio-gas is used as a fuel in generating steam along with conventional fuel oil. The high pressure steam is first sent to the STEAM TURBINE and the exhaust steam is used in the process of manufacturing Alcohol.

The following details are extracted from the financial accounts and cost accounting records of SRIZONI LTD. for the year ended March 31, 2016:

	Boiler ₹	Steam Turbine ₹
Cost of water	10,48,000	—
Fuel oil	918,85,000	—
Bio-gas Plant Expenses	258,02,000	—
Stores and Chemicals	2,57,000	66,000
Salaries and Wages	29,58,000	7,33,000
Repairs and Maintenance	65,64,000	2,58,000
Depreciation	17,25,000	6,50,000
Other Expenses	39,95,000	1,21,000
High Pressure Steam generated	34,950 MT	
Power generated		25,50,200 KWH

Note: The fall in the Enthalpy value of the steam is 10%

Required:

Prepare two separate cost sheets for steam and power as per the Companies (Cost Records and Audit) Rules 2014 for the year ended March 31, 2016.

Answer:

(i) Statement showing Cost of Steam

Quantity produced: 34,950 mt

	Total amount (₹)	Cost/Mt (₹)
Water	10,48,000	29.98
Fuel oil	9,18,85,000	2,629.04
Bio-gas plant expenses	2,58,02,000	738.25
Stores and chemicals	2,57,000	7.35
Salaries and wages	29,58,000	84.64
Repairs and maintenance	65,64,000	187.81
Depreciation	17,25,000	49.36
Other expenses	39,95,000	114.31
	13,42,34,000	3,840.74

(ii) Statement showing Cost of Power generated by Steam Turbine

Power Generated: 25,50,200 KWH

	Total amount (₹)	Cost/Kwh (₹)
Steam	13,42,34,000	52.64
Stores and chemicals	66,000	0.02
Salaries and wages	7,33,000	0.29
Repairs and maintenance	2,58,000	0.10
Depreciation	6,50,000	0.25
Other expenses	1,21,000	0.05
	1,36,06,2000	53.35
Less: Credit for exhaust steam (90%)	1,22,45,5800	48.02
Cost of Power used in alcohol manufacture	13,60,6200	5.33

Illustration 3.

The following figures relate to usage of power for a product:

	<u>2015-16</u>	<u>2014-15</u>	<u>2013-14</u>
Total power consumed in KWH	24,02,474	24,94,872	21,75,677
Rate / KWH (₹)	2.29	2.12	1.90
Total production in million (Kgs)	337.730	333.084	300.865

Compute necessary productivity measures and compare the efficiency of power usage during the three years.



Answer:

	<u>2015-16</u>	<u>2014-15</u>	<u>2013-14</u>
Power consumed in Kwh	24,02,474	24,94,872	21,75,677
Rate per Kwh (₹)	2.29	2.12	1.90
Total Power cost (₹)	55,01,665	52,89,129	41,33,786
Production (in million kgs)	337.730	333.084	300.865
	(337730 MT)	(333084 MT)	(300865 MT)
Power cost/MT (₹)	16.29	15.88	13.74
Power usage MT (KWH)	7.11	7.49	7.23

Variances over previous year:

Rate (₹) [(24,02,474) × (2.29 – 2.12)]	4,08,420 (A)	5,48,872 (A)
Volume (₹)	73,774 (A)	4,42,678 (A)
Usage (₹)	2,69,658 (F)	1,63,793 (A)
	2,12,536 (A)	11,55,343 (A)

Calculation of variances:

Volume variance:

	<u>2015-16</u>	<u>2014-15</u>	<u>2013-14</u>
Total power consumed (Kwh)	24,02,474	24,94,872	21,75,677
Rate per Kwh ₹	2.29	2.12	1.90
Rate variance	24,02,474 (2.12 – 2.29)	24,94,872 (1.90 – 2.12)	
	= ₹4,08,421 (A)	= ₹5,48,872 (A)	
Production in Mill Kg	337.730	333.084	300.865

Volume variance:

2015-16 & 2014-15	(33084 – 337730) × 15.88 = ₹ 73,778 (A)
2014-15 & 2013-14	(300865 – 333084) × 13.74 = ₹ 4,42,689 (A)

Usage variance:

2015-16 & 2014-15

$$2,12,536 - 4,08,421 - 73,778 = ₹ 2,69,663 (F)$$

2014-15 & 2013-14

$$11,55,343 - 5,48,872 - 4,42,689 = ₹ 1,63,782 (A)$$

Total variance:

2015-16 & 2014-15	52,89,129 – 55,01,665 = ₹ 2,12,536 (A)
2014-15 & 2013-14	41,33,786 – 52,89,129 = ₹ 11,55,343 (A)

12.4 CAPACITY DETERMINATION AND UTILISATION

Capacity is the maximum level of output that a company can sustain to make a product or provide a service. Planning for **capacity** requires **management** to accept limitations on the production process.

Cost Accounting Standard - 2 (Revised 2015) on "Capacity Determination" issued by the Council of the Institute of Cost Accountants of India.

This standard deals with the principles and methods of classification and determination of capacity of an entity for ascertainment of the cost of product or service, and the presentation and disclosure in cost statements.

The objective of this standard is to bring uniformity and consistency in the principles and methods of determination of capacity with reasonable accuracy.

Installed capacity: Installed capacity is the maximum capacity of producing goods or providing services, determined either based on technical specification of the facility or through a technical evaluation.

Normal capacity is the volume of production or services achieved or achievable on an average over a period under normal circumstances taking into account the reduction in capacity resulting from planned maintenance.

Actual capacity utilization: Actual capacity utilization is measured in terms of volume of production achieved or service provided in a specified period.

Capacity shall be determined in terms of units of production or services or equivalent machine or man hours.

Illustration 1.

As a Cost and Management Auditor, you are asked to look into the proposed decision to temporarily suspend operations due to depressed market conditions:

₹ In '000

Budgeted level (per annum)	Capacity Utilization	
	60%	80%
Direct Material	1,800	2,400
Direct Labour	2,400	3,200
Production overhead	1,260	1,380
Administrative Overhead	620	660
Selling & Distribution overhead	680	740
Total	<u>6,760</u>	<u>8,380</u>

The company is likely to operate at 50% capacity only and turnovers expected to be Rs. 49.5 lakhs p.a. Market Research indicates that the depression will be over in a year and after that they can effect a sale of Rs. 90 lakhs p.a utilizing 75% of capacity.

If operations are suspended for a year, the following cost will be incurred:

- Fixed cost ₹ 4,00,000
- Settlement with labour force ₹ 3,50,000
- Maintenance of Plant will continue and cost ₹ 1,00,000
- Cost of reopening will be ₹ 1,00,000

Draft a report to the Management of the following two options:

- (i) To suspend production for one year and restart thereafter when market improves.
- (ii) To continue production at 50% capacity level.



Answer:

Draft report is as follows:

To,
The Managing Director,

Dear Sir,

Sub: Report on proposal for temporary suspension of operations due to depressed market conditions:

This has reference to your letter no. _____ dated _____ .

As desired, I have examined carefully both the options that are available viz.,

- (i) To suspend production for one year and restart thereafter when market improves.
- (ii) To continue production at 50% capacity level.

Due to depressed market conditions, the plant has to be operated only at a low cost capacity utilization of 50%. The market research report has predicted that the adverse market conditions are going to be a temporary phenomenon for a period of only one year. Thereafter that they can effect a sale of ₹ 900 lakhs p.a utilizing 75% of capacity.

Details pertaining to the feasibility of both the options are as under:

Option I: Suspension of production for one year

₹ In '000

Fixed cost	400
Settlement with labour force	350
Maintenance of Plant	100
Cost of reopening	<u>100</u>
Total	<u>950</u>

Option II: continue production at 50% capacity level.

₹ In '000

Particulars	Current Year	Next Year
	50% capacity	75% capacity
Direct Material	1,500	2,250
Direct Labour	2,000	3,000
Production overhead	1,200	1,350
Administrative Overhead	600	650
Selling & Distribution overhead	650	725
Total cost	5,950	7,975
Sales	4,950	9,000
Profit/(Loss)	(-)1,000	1,025

Analysis of the above comparative data shows that if company continues operation at 50% capacity, there will be loss of ₹. 10 lakhs.

On other hand, if operations are suspended, the loss will be ₹ 9.50 lakhs. Thus there is additional loss of ₹ 50000/- only.

If the operations are suspended, the company may have to encounter the following problems:

- Problems of recruiting new personnel,
- Links with old customers will be broken,
- It may have an adverse effect on the image of the company.

Attaining 75% capacity utilization immediately after closer for a year may not be easy to achieve. It may therefore be seen from the above that even though the company may just save ₹50000/-, by doing so it may have to face a lot of difficulties as listed above.

Final recommendation: The company is advised to continue production at 50% capacity utilization and never mind the small loss of ₹ 50000/- by continuing production in view of factors discussed above.

Hope you find the above report and analysis in order.

Thanking you ,

Sd.

(Cost and Management Auditor.)

Working notes:

(I) Direct Material Cost is 100% variable cost.

Direct material cost at 75% Capacity = $18,00,000/60 \times 75 = ₹ 22,50,000$

Direct material cost at 50% Capacity = $18,00,000/60 \times 50 = ₹ 15,00,000$

(II) Direct Labour Cost is 100% variable cost.

Direct Labour Cost at 75% capacity = $24,00,000/60 \times 75 = ₹ 30,00,000$

Direct Labour Cost at 50% capacity = $24,00,000/60 \times 50 = ₹ 20,00,000$

(III) Production Overhead is a semi variable cost.

At 80%, Production Overhead is ₹13,80,000

At 60%, Production Overhead is ₹12,60,000

For 20% variation, difference is ₹ 1,20,000

Variable production overhead at 60% capacity = $1,20,000/20 \times 60 = ₹ 3,60,000$

Fixed production overhead = ₹ 12,60,000 - ₹ 3,60,000 = ₹ 9,00,000

Thus at 50% capacity, Fixed production overhead = ₹9,00,000 and

Variable production overhead = ₹ 360000/60*50 = ₹3,00,000.

Similarly, at 75% Capacity,

Variable production overhead = $3,60,000/60 \times 75 = ₹ 4,50,000$

Total production overhead = ₹9,00,000 + ₹4,50,000 = ₹13,50,000



(IV) Administrative overhead is a semi variable overhead.

At 80% capacity, Administrative overhead = ₹ 6,60,000

At 60% capacity, Administrative overhead = ₹ 6,20,000

For 20% variation, difference is = ₹ 40,000

At 60% capacity, Variable Administrative overhead = $40,000/20 \times 60 = ₹1,20,000$

Thus, Fixed Administrative overhead = ₹ 6,20,000 - ₹1,20,000 = ₹5,00,000

Similarly, at 50% capacity,

Variable Administrative overhead = ₹ 1,20,000/60*50 = ₹1,00,000

Total Administrative overhead = ₹ 5,00,000 + 1,00,000 = ₹6,00,000

At 75% capacity,

Variable Administrative overhead = $1,20,000/60 \times 75 = ₹1,50,000$

Thus Total Administrative overhead = ₹5,00,000 + ₹1,50,000 = ₹6,50,000.

(V) Selling and Distribution Overhead:

This is semi variable overhead.

At 80% , S&D OH = ₹7,40,000

At 60%, S&D OH = ₹6,80,000

For 20% variation, difference is = ₹ 60,000

Thus, at 60% capacity, variable S&D o/h = $6,000/20 \times 60 = ₹1,80,000$

Fixed OH at 60% capacity = ₹6,80,000 - ₹1,80,000 = ₹5,00,000

Thus at 50% capacity,

Variable S&D O/H = $1,80,000/60 \times 50 = ₹1,50,000$

Total S&D O/H = ₹ (1,50,000+5,00,000) = ₹6,50,000

Similarly at 75% capacity,

Variable O/H = $1,80,000/60 \times 75 = ₹ 2,25,000$

Total O/H = ₹ 2,25,000 + ₹ 5,00,000 = ₹ 7,25,000

Illustration 2.

A company manufactures two products X and Y. Product X requires 8 hours to produce while Product Y requires 12 hours. In April, of 22 effective working days of 8 hours a day, 1,200 units of X and 800 units of Y were produced. The Company employs 100 workers in the Production Department to produce X and Y. The Budgeted Hours are 1,86,000 for the year. Calculate Capacity, Activity and Efficiency Ratio and establish their inter-relationship.

Answer:

Budget-Ratios can be easily computed using the FOH Variance Computation Chart, given below:-

When FOH Volume Variance related ratios are to be computed, the working notes are as under -

WN	(1)	(2)	(3)	(4)	(5)
Cost Factor	AO x SR	AH x SR	PFOH	BFOH	AFOH
Time Factor included in above	SH = Standard Hours	AS = Actual Hours	PH = Possible Hours	BH = Budgeted Hours	
Hours	(1,200 x 8) + (800 x 12) = 19,200 hours	22 days x 8 hours x 100 men = 17,600 hours	(Not Applicable in this question.)	$\frac{1,86,000}{12 \text{ months}}$ = 15,500 hours	Not Applicable for Ratio Computation

Ratio	Time-based Computation	Output-based computation	WN Reference and Answer
1. Efficiency Ratio	$\frac{\text{Standard Hours}}{\text{Actual Hours}}$	$\frac{\text{Actual Output}}{\text{Standard Output}}$	$\frac{\text{WN 1 } 19,200 \text{ hours}}{\text{WN 2 } 17,600 \text{ hours}} = 109.09\%$
2. Capacity Ratio	$\frac{\text{Actual Hours}}{\text{Budgeted Hours}}$	$\frac{\text{Standard Output}}{\text{Budgeted Output}}$	$\frac{\text{WN 2 } 17,600 \text{ hours}}{\text{WN 4 } 15,500 \text{ hours}} = 113.55\%$
3. Volume or Level of Activity Ratio	$\frac{\text{Standard Hours}}{\text{Budgeted Hours}}$	$\frac{\text{Actual Output}}{\text{Budgeted Output}}$	$\frac{\text{WN 1 } 19,200 \text{ hours}}{\text{WN 4 } 15,500 \text{ hours}} = 123.87\%$

Relationship: Activity Ratio = Capacity Ratio x Efficiency Ratio = 113.55% x 109.09% = 123.87%.

Illustration 3.

Manufacture's specification capacity for a machine per hour = 1500 units

No. of shifts (each shift of 8 hours each) = 3 shifts

Paid holidays in a year (365 days) :

Sundays 52 days

Other holidays 8

Annual maintenance is done during the 8 other holidays.

Preventive weekly maintenance is carried on during Sundays.

Normal idle capacity due to lunch time, shift change etc=1hour.

Production during last five years = 76.20, 88, 65.82, 78.5, 76.6 lac units.

Actual production during the year = 76.40 units.

Calculate Installed capacity, Available capacity, Actual capacity, Idle capacity and Abnormal idle capacity as per CAS 2 from the data given.



Answer:

$$\begin{aligned}\text{Installed capacity for the machine} &= 365 \times 8 \times 3 \times 1500 \\ &= 131.40 \text{ lac units}\end{aligned}$$

$$\begin{aligned}\text{Available capacity} &= (365 - 52 - 8) \times (8 - 1) \times 3 \times 1500 \\ &= 305 \times 7 \times 3 \times 1500 \\ &= 96.08 \text{ lac units}\end{aligned}$$

$$\begin{aligned}\text{Normal capacity} &= (76.2 + 78.5 + 76.6) / 3 \\ &= 77.1 \text{ lac units.}\end{aligned}$$

$$\begin{aligned}\text{Actual capacity utilization} &= 76.4 \text{ lac units} \\ &= 76.4 / 131.4 \times 100 \\ &= 58.14\%\end{aligned}$$

$$\begin{aligned}\text{Idle capacity} &= (131.40 - 76.4) \text{ lac units} \\ &= 55 \text{ lac units} \\ &= 55 / 131.4 \times 100 \\ &= 41.86\%\end{aligned}$$

$$\begin{aligned}\text{Abnormal idle capacity} &= (77.1 - 76.4) \text{ lac units} \\ &= 0.70 \text{ lac units}\end{aligned}$$

Illustration 4.

The following data have been collected by you, as a Cost Auditor of a Company:

Particulars	13-14	14-15	15-16
Installed Capacity (lac MT)	2.5	2.5	2.5
Production (lac MT)	2.4	2.3	1.25
Cost/MT of the product (₹)	1000	1077	1660

The poor capacity utilization in 2015-16 was due to abnormal power cut. The escalation in costs were 5% in 14-15 and 2% over 14-15 in 2015-16.

- (i) Calculate the abnormal cost due to power cut.
- (ii) How would you treat these abnormal cost?

Answer:

Particulars	13-14	14-15	15-16
Installed Capacity (lac MT)	2.5	2.5	2.5
Production (lac MT)	2.4	2.3	1.25
% of Capacity Utilisation	96	92	50
Cost per unit (₹/MT)	1000	1077	1660
Escalation factor	100	105	107
Cost at Base Year price	1000	1025	1551
Total cost of production (₹ in lakhs)	2400	2359.8	1938.75
Variable cost /MT	402	402	402
Fixed cost /MT	598	623	1149
Fixed cost @100% utilisation	574		

Hence, increase in Fixed Cost /MT due to poor capacity utilization in 2015-16 is = 1149 - 574 = ₹575.

- (i) Abnormal cost due to power cut = 575 × 1.25 = ₹ 718.75
- (ii) The abnormal cost must be excluded from computation of Cost.

Working Notes:

As compared to 13-14	14-15	15-16
(A) Difference in total cost (₹ in lakhs)	2,400 - 2,359.8 = 40.2	2,400-1,938.75 = 461.25
(B) Difference in Production (lac MT)	2.4-2.3 = 0.1	2.4-1.25 = 1.15
Variable Cost/MT (₹) (A)/(B)	402	402 approx

Illustration 5.

As a Cost Auditor of a manufacturing company, furnish your suggestions and observations based on following information: (You may make necessary assumptions):

Particulars	2015	2014
Profit (₹ in lakhs)	250	340
Capacity Utilisation	90%	95%
Consumption of Electricity/Tonne of output (KWH)	4.07	3.98
Capital Employed (₹ in lakhs)	1,200	1,100
Salaries and Wages (₹ in lakhs)	117	98
Production (MT)	1,80,000	1,90,000

Answer:

Cost Auditor's Observations and Conclusions:

The profit of the company has declined by ₹ 90 lakhs during the year 2015, as compared to the year 2014.

This may be due to the following reasons:

- (i) Production during the year 2015 has decreased by 10,000 MT. This is perhaps due to underutilization of capacity from 95% to 90%. It may also be due to scarce power supply.



- (ii) Based on further analysis and scrutiny, it is noted that the cost of production/ Tonne has increased (Assumption.)
- (iii) It has also come to light that the price of the product in the market has declined. This may be due to stiff competition. (Assumption)
- (iv) Profit as a % of Capital Employed has declined from the figure of 30.9% in 2014 to 20.8% in the year 2015. This is partly due to decline in the amount of profit and partly due to increase in capital employed.
- (v) The consumption of electricity in terms of KWH/ tonne of output has increased from 3.98 in 2014 to 4.07 in 2015. This is a serious matter which need investigation and necessary action is to be initiated.
- (vi) There is an increase in the Salaries and Wages by ₹19 lakhs. This is due to the following reasons:
 - (A) Increase in ₹7 lakhs due to increments and promotions. (Assumptions)
 - (B) Increase in ₹3 lakhs due to additional DA paid to the workers. (Assumptions)
 - (C) Remaining ₹9 lakhs is due to employment of new workers. (Assumptions)

Engagement of these new workers is not justified on economic considerations and this has resulted in excessive idle time. Additional work needs to be created for these workers.

12.5 VALUE ADDITION

The term " Value Addition" has been defined under the Companies (Cost Records and Audit) Rules, 2014 as the difference between net output value (net sales adjusted for WIP and finished stock) and cost of bought out materials and services for the product under reference.

Annexure to the Cost Audit Report - Part D prescribes the method of calculation of Value Addition. Value Added has to be established with reference to activity carried out during the year under reference.

Illustration 1.

From the following figures extracted from the financial and cost accounting records, you are required to compute:

- (i) Value Added.
- (ii) Ratio of Operating Profit to Sales.
- (iii) Ratio of Operating Profit to Value Added.

Particulars	₹ in lakhs
Net Sales excluding Excise Duty	21,000
Increase in Stock of finished goods	250
Expenses:	
Raw Materials consumed	2,600
Packing materials consumed	1200
Stores and spares consumed	560
Power and fuel	4,600
Repairs and maintenance	200
Insurance	120
Direct salaries and wages	480
Depreciation	885
Interest paid	1,398

Factory overhead:		
Salaries and wages		240
Others		250
Selling and distribution expenses:		
Salaries and wages		120
Additional sales tax		457
Others		1,700
Administration overheads:		
Salaries and wages		120
Others		80

Answer:

(i)		₹ in lakhs	₹ in lakhs
	Computation of Value Added		
	Net Sales+ Increase in Stock of Finished Goods		21,250
	Less:		
	Cost of bought out materials and services:		
	Raw Materials	2,600	
	Packing Materials	1,200	
	Stores and Spares	560	
	Power and fuel	4,600	
	Repairs and Maintenance	200	
	Insurance	120	
	Other factory overhead	250	
	Other Selling & distribution overhead	1,700	
	Other Administration overhead	80	11,310
	Value Added	9,940	
	Composition of Value Added:		
	Depreciation	885	
	Interest	1,398	
	Additional Sales tax	457	
	Salaries and wages (480+240+120+120)	960	3,700
	Profit before tax (balancing figure)		6,240
	Operating Profit:		
	PBT	6,240	
	Interest paid	1,398	
			7,638

(ii) Ratio of operating profit to net sales = $\frac{\text{Operating profit}}{\text{Net sale}} = \frac{7,638}{21,000} \times 100 = 36.37$

(iii) Ratio of operating profit to value added = $\frac{\text{Operating profit}}{\text{Value Added}} = \frac{7,638}{9,940} \times 100 = 76.84$



Illustration 2.

The president of the HT Company has just returned from a management seminar in which the benefits of economic value added have been trumpeted. He wants to know what the calculation would be for HT, and asks his financial analyst to find out.

The financial analyst knows that the company's cost of capital is 12.5%, having recently calculated it from the company's mix of debt, preferred stock, and common stock. He then reconfigures information from the income statement and balance sheet into the following matrix, where some expense line items are instead treated as investments.

Account Description	Performance	Net Investment
Revenue	\$6,050,000	
Cost of goods sold	4,000,000	
General & administrative	660,000	
Sales department	505,000	
Training department		\$75,000
Research & development		230,000
Marketing department	240,000	
Net income	\$645,000	
Fixed assets		3,100,000
Cost of patent protection		82,000
Cost of trademark protection		145,000
Total net investment		\$3,632,000

The return on investment for HT is 17.8%, using the information from the preceding matrix. The calculation is \$645,000 of net income divided by \$3,632,000 of net investment. Finally, he includes the return on investment, cost of capital, and net investment to calculate Economic Value Added.

Find the EVA.

Answer:

$(\$3,632,000 \text{ Net investment}) \times (17.8\% \text{ Actual return} - 12.5\% \text{ Cost of capital})$

$= \$3,632,000 \text{ Net investment} \times 5.3\%$

$= \underline{\$192,496} \text{ Economic value added}$

Thus, the company is generating a healthy economic value on the funds invested in it.

12.6 INVENTORY VALUATION

An **inventory valuation** allows a company to provide a monetary value for items that make up their inventory. Inventories are usually the largest current asset of a business, and proper measurement of them is necessary to assure accurate financial statements. If inventory is not properly measured, expenses and revenues cannot be properly matched and a company could make poor business decisions. **Inventory management** is the process of efficiently overseeing the constant flow of units into and out of an existing inventory.

The inventory valuation involves two major aspects:

- The cost of the purchased or manufactured inventory has to be determined and
- Such cost is retained in the inventory accounts of the company until the product is sold.

Costs of Inventories Cost of inventory can be classified as

- (a) Costs of purchase
- (b) Costs of conversion
- (c) "Other costs" incurred in bringing the inventories to their present location and condition

Costs that are excluded from inventory valuation Certain costs are excluded in valuing inventory are:-

- (a) Abnormal amounts of wasted materials, labor, or other production costs
- (b) Storage costs unless they are essential to the production process
- (c) Administrative overheads that do not contribute to bringing inventories to their present location and condition
- (d) Selling costs.

TECHNIQUES OF MEASUREMENT OF COSTS

Several acceptable methods of handling those are

- (i) Specific identification.
- (ii) Average cost.
- (iii) First-in, first-out (FIFO).
- (ii) Last-in, first-out (LIFO).

Illustration 1.

A nationalized bank which has extended cash credit to a manufacturing company on the security of the inventory holding, is periodically receiving stock statements from the company indicating the value of stocks held. The company is sick and the Bank wants to reassure itself that its loans are fully covered by stocks. You have been appointed by the Bank to certify the value of the inventory. How would you proceed to conduct the 'inventory audit?'

Answer:

Inventory Audit involves the following aspects:

- (i) Physical verification of stocks.
 - (ii) Method of valuation adopted.
 - (iii) Currency of stocks (i.e., movement)
- (i) Physical verification of stocks** — Physical verification of stocks will normally be 100 percent. However, depending upon the nature of items and material flows, it may be done by sampling. This will require proper sampling procedures to ensure the samples verified represent the characteristics of entire stock. An ABC categorization may be done so that right emphasis is given to each item of stock.



(ii) **Method of valuation adopted** — The main thrust of inventory audit is to check the accuracy of the costs, to verify the market rates and to see that the values adopted for stock valuation are cost price or net realisable value whichever is lower. Basis of valuation adopted for Raw Materials, Work-in process, Finished Goods and Spares and Consumables must be examined and reasonableness verified to ensure the realizable values. For imported items foreign exchange translation rate for conversion will be:

- (a) as per bank debits under LC, or
- (b) rate prevalent as evidenced by Bill of Entry (or Forward Rate if Forward Contract has been taken (for imports on D.A. terms or on account).

(iii) **Currency of stocks** — Currency of stocks will be ensured by analyzing all items by fast, slow and non-moving characteristics. In respect of slow and non-moving items, fall in value, if any, due to obsolescence, deterioration etc. will also have to be examined and reported.

In respect of spare parts, care must be taken to segregate items of spares relating to scrapped or replaced plant/machinery, as these may not have any value.

In finished goods also, returns from customers for defects in quality must be given special consideration in valuation.

(iv) The basis of the unit rates adopted must be consistent and include:

- (a) Freight, insurance, octroi, packing, loading and unloading and other incidental charges incurred.
- (b) Manufacturing costs upto stages of completion in case of finished product.

The report may be designed by the bank or designed by the Cost Auditor. In any case some items which need to be highlighted should be shown separately. The report should contain lacuna, if any, improvements required, and suggestions for improvement. Needless to say the report should not only be useful to client, i.e bank but also to the unit whose audit is carried out to enable them to improve their performance.

Illustration 2.

Purchase of Materials ₹ 3,00,000 (inclusive of Trade Discount ₹ 3,000); Fee on Board ₹12,000; Import Duty paid ₹15,000; Freight inward ₹ 20,000; Insurance paid for import by sea ₹ 10,000; Rebates allowed ₹ 4,000; Cash discount ₹3,000; CENVAT Credit refundable ₹ 7,000; Subsidy received from the Government for importation of these materials ₹ 20,000. Compute the landed cost of material (i.e. value of receipt of material).

Answer:

(a) Computation of Material Cost Sheet

	Particulars	Amount (₹)
	Purchase price of Material	3,00,000
Add:	Fee on Board	12,000
Add:	Import Duties of purchasing the material	15,000
Add:	Freight Inward during the procurement of material	20,000
Add:	Insurance paid	10,000
	Total	3,57,000
Less:	Trade Discount	3,000
Less:	Rebates	4,000
Less:	CENVAT Credit refundable	7,000
Less:	Subsidy received from the Government for importation of materials	20,000
	Value of Receipt of Material	3,23,000

Note:

- (i) Cash discount is not allowed, as it is a financial item.
- (ii) Subsidy received, rebates and CENVAT Credit refundable are to be deducted for the purpose of computing the material cost.

Illustration 3.

Purchase of Materials \$ 50,000 [Forward contract rate \$ = ₹54.40 but \$ = ₹54.60 on the date of importation] ; Import Duty paid ₹5,65,000; Freight inward ₹1,62,000 ; Insurance paid for import by road ₹48,000; Cash discount ₹33,000; CENVAT Credit refundable ₹37,000; Payment made to the foreign vendor after a month, on that date the rate of exchange was \$ = ₹55.20. Compute the landed cost of material.

Ans:

Computation of Landed Cost of Material

	Particulars	Amount (₹)
	Purchase price of Material [50,000 x 54.60]	27,30,000
Add	Import Duties of purchasing the material	5,65,000
Add	Any taxes paid during the purchase of material	1,62,000
Add	Freight Inward during the procurement of material	48,000
	Total	35,05,000
Less	CENVAT Credit refundable	37,000
	Value of Receipt of Material	34,68,000

- (i) Excess payment made to the vendor due to exchange fluctuation is not an includible cost, hence not considered.
- (ii) Though the forward contract rate was \$ = ₹54.40, but the exchange rate on the date of importation is considered. Hence, included in the cost of materials. Accordingly, the purchase cost is computed considering the \$ = ₹54.60.

Illustration 4.

Opening stock of raw materials (5,000 units) ₹ 1,80,000; Purchase of Raw Materials (17,500 units) ₹ 7,00,000; Closing Stock of Raw Materials 3,500 units; Freight Inward ₹ 85,000; Self-manufactured packing material for purchased raw materials only ₹60,000 (including share of administrative overheads related to marketing sales ₹ 8,000); Demurrage charges levied by transporter for delay in collection ₹ 11,000; Normal Loss due to shrinkage 1% of materials ; Abnormal Loss due to absorption of moisture before receipt of materials 100 units. Calculate the value of Closing Stock.

Answer:

Computation of value of closing stock of raw materials [Average Cost Method]

	Particulars	Quantity (Units)	Amount (₹)
	Opening Stock of Raw Materials	5,000	1,80,000
Add	Purchase of raw materials	17,500	7,00,000
Add	Freight inwards		85,000
Add	Demurrage Charges levied by transporter for delay in collection		11,000
			9,76,000
Less	Abnormal Loss of raw materials (due to absorption of moisture before receipt of materials) = $[(7,00,000 + 85,000 + 11,000) \times 100] / 17,500$	(100)	(4,549)
Less	Normal loss of materials due to shrinkage during transit [1% of 17,500 units]	(175)	-----
Add	Cost of self-manufactured packing materials for purchased raw materials only (60,000 – 8,000)		52,000



	Cost of raw materials	22,225	10,23,451
Less:	Value of Closing Stock = Total Cost / (Total units – Units of Normal Loss) [10,23,451/(5,000+17,500 – 175)]x 3,500	(3,500)	(1,60,451)
	Cost of Raw Materials Consumed	18,725	8,63,000

Note:

- (i) Units of normal loss adjusted in quantity only and not in cost, as it is an includible item
- (ii) Cost of self-manufactured packing materials does not include any share of administrative overheads or finance cost or marketing overheads. Hence, marketing overheads excluded.
- (iii) Abnormal loss of materials arose before the receipt of the raw materials, hence, valuation done on the basis of costs related to purchases only. Value of opening stock is not considered for arriving at the valuation of abnormal loss.
- (iv) Demurrage charges paid to transporter is an includible item. Since this was paid to the transporter, hence considered before estimating the value of abnormal loss

12.7 ABNORMAL EVENTS SUCH AS STRIKE, LOCK-OUT AND OTHER FACTORS

As per (CAS-6) COST ACCOUNTING STANDARD ON MATERIAL COST, any abnormal cost shall be excluded from material cost. So cost of Abnormal Events such as Strike, Lock Out and other factors are not included in Cost.

Illustration 1.

There was a strike from 13.09.2015 to 16.11.2015 in a company of which you were the Cost Auditor for the year ending 31.03.2016. Although the company began working from 17.11.2015, production could effectively begin only from 5.12.2015. The expenses incurred during the year ended 31.03.2016 were:

	(₹ in lakhs)
Salaries & Wages (direct)	450
Salaries & Wages (indirect)	300
Power (variable)	180
Depreciation	270
Other Fixed Expenses	360

Detailed examination of the records reveals that of the above, the following relate to the period 13.09.2015 to 16.11.2015:

	(₹ in lakhs)
Salaries & Wages (indirect)	105
Depreciation	90
Other Fixed Expenses	135

Calculate the amount which in your opinion should be treated as abnormal for exclusion from the product costs.

Answer:

Calculation of Fixed expenses incurred during the period 17.11.2015 to 04.12.2015

	₹ in lakhs
Total expenses 2015 - 16	1,560
Less: Variable expenses (Electricity)	180
Fixed expenses (2015 - 16)	1,380
Less: Fixed expenses during the strike period	330
Fixed expenses during non-strike period	1,050

Since the strike period was for 65 days, the non-strike period is 300 days. Hence, Fixed expenses attributed to 18 days, i.e., 17.11.2015 to 4.12.2016 is 6% of ₹1,050 lakhs = ₹63 lakhs.

Therefore, Expenses incurred during 13.9.15 to 16.11.15	₹ 330 lakhs
For expenses incurred during 17.11.2015 to 04.12.2015	₹ 63 lakhs
Total	₹ 393 lakhs

Hence, ₹ 393 lakhs is to be treated as abnormal cost and should be excluded from the product cost.

Illustration 2.

You are the Internal Auditor of Arena Manufacturing Ltd. The Managing Director has asked you to enquire into the cause of abnormal wastage of raw materials during the month of April. The wastage percentages for the last few months are: Jan. — 1.3%, Feb. — 1.1%, Mar. — 1.3% and Apr. — 3.9%. How will you proceed to carry out the assignment?

Answer:

The rate of wastage in the month of April is about 3 times than that of the previous months. Hence, it may be considered as abnormal. In respect of audit of abnormal wastage, the Auditor should proceed on the following lines —

1. General:

- (i) Procure a list of Raw Materials, showing the names and detailed characteristics of each Raw Material.
- (ii) Enquire whether there is any change which will affect material wastage, e.g. changes in - (I) source of supply of raw materials, (II) methods or process, (III) operating condition of machines, (IV) labour force i.e. replacement of experienced employees by raw hands etc.
- (iii) Enquire whether any new production line was taken up during the month in respect of which standard Input-Output Ratio is yet to be set up.

2. Wastage Figures:

- (i) Obtain the standard consumption figures, and ascertain the basis of computation of normal wastage figures.
- (ii) Examine whether the basis adopted for wastage calculation for the month of April is the same as that adopted for the other three months.
- (iii) See the breakup of normal wastage - (I) transit, (II) storage, (III) handling, and (IV) processing.
- (iv) Obtain a statement showing break up of wastage figures, (as above) for the four months under review and compare the results of the analysis for each of the four months.



3. Consumption Records: Examine the following to find out material variances / deviations if any -

- (i) Purchase of various lots,
- (ii) Identification of each lot with actual material consumption, and
- (iii) Ascertaining actual wastage figures.

4. Abnormal Process Loss:

- (i) **Material Quality:** Examine inspection and testing reports to find out if raw material purchased are of poor quality or sub-standard. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.
- (ii) **Machine Utilisation:** Machine breakdown, power failure, etc. may also result in loss of materials in process. Check Machine Utilisation Statements.
- (iii) **Inspection:** A high rate of rejection in the finished lots may also be responsible for abnormal wastage. Examine the Inspection Reports for the inspection carried out on the completion of each stage of work or process.
- (iv) **Old Lot Consumption:** It is possible that the wastage may have occurred because, the particular lot out of which issues were made in April was lying in the store for a long time, leading to deterioration in quality, or because of a change in weather, which may have led to the deterioration.
- (v) **Previous period comparison:** Compare the wastage figures of April this year with that of April last year and see whether there is any correlation.

5. Abnormal Storage and Handling Loss: This can happen due to -

- (i) Write-offs on account of reconciliation of physical and book-stocks. In case of periodical physical stock-taking, such write offs will be reflected only in the month in which reconciliation takes place.

Accidental, theft or fire losses in storage. The Auditor should examine such possibilities.

12.8 PROFITABILITY ANALYSIS

Profitability analysis is a component of resource planning that allows administrators to forecast the profitability of a proposal or optimize the profitability of an existing project. Profitability analysis can anticipate sales and profit potential specific to aspects of the market such as customer age groups, geographic regions, or product types.

Profitability analysis helps an enterprise to:

- Identify the most and least profitable products or services.
- Discover which sources of information offer the most reliable facts.
- Optimize responses to changing customer needs.
- Evolve the product mix to maximize profits in the medium and long term.
- Isolate and remedy the causes of decreasing profit margins.

Profitability Ratio Analysis forms part of Part D of the Annexure to Cost Audit Report.

Illustration 1.

The Total Overhead Expenses of a factory are ₹4,46,380. Taking into account the normal working of the factory, Overhead was recovered in production at ₹1.25 per hour. The actual hours worked were 2,93,104. How would you proceed to close the books of accounts, assuming that besides 7,800 units produced to which 7,000 were sold, there were 200 equivalent units in WIP?

On investigation, it was found that 50% of the Unabsorbed Overhead was on account of increase in the cost of indirect Materials and Indirect Labour and the remaining 50% was due to factory inefficiency. Also give the profit implication of the method suggested.

Answer:

- (i) Difference in Absorption = Absorbed OH (-) Actual OH
 = (₹1.25 per hour x 2,93,104 hours) – ₹4,46,380 = ₹80,000 (under absorption)
 Normal Increase in OH Costs 50% = ₹40,000
 Treated as Cost and apportioned to -
 Units Sold (7,000 units) = ₹35,000
 Closing Stock of Finished Goods (800 units) = ₹4,000
 Closing Stock of WIP 200 units (equivalent Units) = ₹1,000

So, Supplementary OH Recovery Rate = ₹5 per unit.

Abnormal Items	₹
Factory In-inefficiency	40,000
Treated as LOSS and debited to Costing P&L	

Notes:

- Supplementary OH Recovery Rate = $\frac{\text{Total OH}}{\text{Total Output Qty.}} = \frac{₹ 40,000}{8,000 \text{ Units}} = ₹5 \text{ per unit.}$

This calculation can be based on either Units Sold, (or) Closing Stock of FG, (or) Closing Stock of WIP, (or) Total of all these.

(ii) Journal Entries

(₹ in rupees)

Transaction/Narration	Particulars	Dr.	Cr.
1. Production OH incurred	Production OH Control A/c	Dr.	4,46,380
	To General Ledger Adjustment A/c.		4,46,380
2. Production OH absorbed (₹1.25 per hour × 2,93,104 days)	WIP Control A/c	Dr.	3,66,380
	To Production OH Control A/c.		3,66,380
3. Treatment of Under absorption	Cost of Sales A/c	Dr.	35,000
	Finished Goods Control A/c	Dr.	4,000
	WIP Control A/c	Dr.	1,000
	Costing P&L A/c	Dr.	40,000
	To Factory OH Control A/c		80,000



(iii) Impact on Profit

- OH absorbed into production is only ₹3,66,380 whereas OH actually incurred is ₹4,46,380. Hence, before passing the Journal Entry for under absorption, profit would have been wrongly over-stated (due to under-absorption / under-statement of costs) by ₹80,000.
- The above wrong over statement of profits is rectified by the Under absorption entry, in the following manner –

Under absorption Amount, (i.e., Profit over-statement amount) = ₹80,000				
Transfer to	Cost of Sales A/c	FG Control A/c	WIP Control A/c	Costing P&L A/c
Amount Transfer	₹35,000	₹4,000	₹1,000	₹40,000
Treatment	Finally transferred to Costing P&L A/c	Included in Value of Closing Stock of FG	Included in Value of Closing Stock of WIP	Transferred to Costing P&L A/c
	Profits of current period will be reduced by ₹35,000	Profit of next period will be reduced by ₹5,000, since Opening Stock will be valued at higher amount.		Profits of current period will be reduced by ₹40,000

Illustration 2.

A manufacturing unit has two machines, viz. M_1 and M_2 . Machine M_1 be used for the production of either Product A or production B or both. Machine M_2 can be used for the production of either product X or product Y or both. In order to met the long term contractual obligations with one of its customers, the unit should produce a minimum quantity of 1,200 units each of A and B and 1,600 units each of X and Y.

The production and cost data for the year 2015 are:

Machine hours available: $M_1 = 7,800$ hours

$M_2 = 7,300$ hours

	Product A	Product B	Product X	Product Y
Per unit of output:				
(a) Machine hours required	2	3	3	1
(b) Selling price (₹)	350	465	540	235
(c) Direct material cost (₹)	120	135	150	100

Per machine hour	M_1	M_2
(a) Direct labour (₹)	65	80
(b) Variable overhead (₹)	15	22

Fixed overhead per annum ₹5 lakhs

An additional expenditure involving a fixed overhead of ₹40,000 per annum will convert the M_1 and M_2 into a versatile centre so that any of the four products can be manufactured on these two machines.

As a management consultant advise whether conversion of machines should be undertaken or not.

Answer:

	Machine M_1		Machine M_2	
	A	B	X	Y
Minimum production (units)	1,200	1,200	1,600	1,600
Machine hours required (per unit)	2	3	3	1
Minimum machine hours required	2,400	3,600	4,800	1,600
Total Machine hours required	6,000		6,400	

Computation of contribution per unit

	Machine M ₁		Machine M ₂	
	A	B	X	Y
Selling Price	350	465	540	235
Less: Direct material Cost	120	135	150	100
Less: Direct labour (Rate per machine hour x hours)	(65 x 2) 130	(65 x 3) 195	(80 x 3) 240	(80 x 1) 80
Less: Variable overhead	(15 x 2) 30	(15 x 3) 45	(22 x 3) 66	(22 x 1) 22
Contribution per unit	70	90	84	33
Machine hours required for 1 unit	2	3	3	1
Contribution per machine hour	35	30	28	33
Rank	I	II	II	I

Computation of total contribution

	Machine M ₁		Machine M ₂	
	A	B	X	Y
Contribution per machine hour	35	30	28	33
Minimum machine hours required	2,400	3,600	4,800	1,600
Contribution	84,000	1,08,000	1,34,400	52,800

Total Contribution (A + B + C + D) = 3,79,200
 Less: Fixed Overhead = 5,00,000
 Profit (1,20,800)

If machine M₁ & M₂ convert into versatile centre

Computation of contribution per unit -

	Machine M ₂		Machine M ₁	
	A	B	X	Y
Selling Price	350	465	540	235
Less: Direct material Cost	120	135	150	100
Less: Direct labour (Rate per machine hour x hours)	(80 x 2) 160	(80 x 3) 240	(65 x 3) 195	(65 x 1) 65
Less: Variable overhead	(22 x 2) 44	(22 x 3) 66	(15 x 3) 45	(15 x 1) 15
Contribution per unit	26	24	150	55
Machine hours required for 1 unit	2	3	3	1
Contribution per machine hour	13	8	50	55
Rank	I	II	II	I

It is assumed that available machine hours and existing demand of products are same. If we convert the machines M₁, then contribution per machine hour of the product X & Y has been increased by ₹22 in each case and in the



case M_2 , contribution per machine hour has decrease by ₹22 in each case. So, it is concluded that maximum contribution is generated in case of product A, B, X & Y if it is manufactured in Machine M_1 . So, machine hours of M_1 are bottleneck.

Computation of total contribution (under bottleneck – Rank-wise)

Machine M_1	Units	Hours available	Contribution per hours	Total Contribution
Products		7,800		
Product Y	1,600	$7,800 - 1,600 \times 1$ $= 6,200$	55	$1,600 \times 1 \times 55$ $= 88,000$
Product X	1,600	$6,200 - 1,600 \times 3$ $1,400$	50	$1,600 \times 3 \times 50$ $= 2,40,000$
Product A	700	$1,400 - 700 \times 2$ $= 0$	35	$700 \times 2 \times 35$ $= 49,000$
Machine M_2		7,300		
Product A	500	$7,300 - 500 \times 2$ $= 6,300$	13	$500 \times 2 \times 13$ $= 13,000$
Product B	1,200	$6,300 - 1,200 \times 3$ $= 2,700$	8	$1,200 \times 3 \times 8$ $= 28,800$
Total Contribution				4,18,800

Increase in total contribution = ₹4,18,800 – ₹3,79,200 = ₹39,600 which is lower than relevant cost of ₹40,000.

Conclusion:

Management can go for the new proposal because difference in increased cost and increased contribution is negligible and if this option is available, organization can get other order in near future which will be managed easily & create wealth to the organisation.

Illustration 3.

TNT Ltd. has received an enquiry for supply of 2,00,000 numbers of Special Type of Machine Parts. Capacity exists for manufacture of the machine parts, but a fixed investment of ₹80,000/- and working capital to the extent of 25% of Sales Value will be required to undertake the job.

The costs estimated as follows:

Raw Materials - 20,000Kgs @ ₹2.50 per kg

Labour Hours- 9,000 of which 1,200 would be overtime hours payable at double the labour rate.

Labour Rate- ₹ 2 per hour.

Factory Overhead - ₹2 per direct labour hours.

Selling and Distribution Expenses - ₹23,000

Material recovered at the end of the operation will be ₹6,000 (estimated).

The Company expects a Net Return of 25% on Capital Employed.

You are Management Accountant of the Company. The Managing Director requests you to prepare a Cost and Price Statement indicating the price which should be quoted to the Customer.

Answer:

Statement of Estimated Cost and Price Quotation

Product: Special Type Machine Parts.	Quantity = 2,00,000 units.	
	₹	₹
Materials (20000 Kgs. @ ₹ 2.50)	50,000	
Less: Estimated Scrap value	6,000	44,000
Labour-		
8000 hrs. @ ₹ 2	15,600	
1000 (OT) hrs. @ ₹4	4,800	20,400
Prime Costs		64,400
Add: Factory overhead (9000 hrs. @ ₹ 2)		18,000
Factory Cost		82,400
Add: Selling and Distribution Expenses		23,000
Total Cost		1,05,400
Add: Profit		28,360
Sales		1,33,760

Selling Price / unit = 1,33,760/2,00,000 = ₹ 0.67

Working Notes:

Calculation of Sales

Let Sales be S

$$S = \text{Total Cost} + 25\% \text{ of Capital Employed.}$$

$$S = 1,05,400 + 25/100 \times (80,000 + S/4)$$

$$S = 1,05,400 + 20,000 + S/16$$

$$S - s/16 = 1,25,400$$

$$15S = 1,25,400 \times 16$$

$$15S = 20,06,400$$

$$S = 1,33,760$$

Sales = ₹1,33,760

Profit = Sales – Cost = 1,33,760 – 1,05,400 = ₹ 28,360

Working Capital = 1/4th of Sales = 1,33,760 x 1/4 = ₹33,440.



Illustration 4.

How Value Chain activity can have an impact in performance analysis?

Answer:

Value Chain — many company attempts to gain competitive advantage by appropriately linking its own activities with those of the suppliers, channels or customers. Vertical-integration, quality controls on inputs from suppliers, total quality management strategies, controlling distributors' performance through training/financing etc., collaborative arrangements etc. are some of the ways in which company's own activities are beneficially linked to other organizations. This provides an avenue for reporting under performance analysis report. What has been the cost of such coordinating strategies and how much of competitive advantage of the company has improved or strengthened at present level? If such linkages with other companies are established as a matter policy, every year, then performance as to the cost efficiency in such coordinating/ cooperating linkages can be an area for appraisal for the Cost Auditor.

Illustration 5.

CMC Public Health Centre runs an Intensive Medical Care Unit. For this purpose, it has hired a building at a rent of ₹ 5,000 per month with the understanding that it would bear the repairs and maintenance charges also.

The unit consists of 25 beds and 5 more beds can be comfortably accommodated when the occasion demands. The permanent staff attached to the unit is as follows:

- (i) 2 Supervisors, each at a salary of ₹ 500 per month.
- (ii) 2 Nurses, each at a salary of ₹ 300 per month.
- (iii) 2 Ward boys, each at a salary of ₹ 150 per month.

Though the unit was open for the patients all the 365 days in a year, scrutiny of accounts in 2015 revealed that only for 120 days in the year, the unit had the full capacity of 25 patients per day and for another 80 days, it had on an average 20 beds only occupied per days. But, there were occasions when the beds were full, extra beds were hired at a charge of ₹ 5 per bed per day and this did not come to more than 5 beds extra above the normal capacity on any one day. The total hire charges for the extra beds incurred for the whole year amount to ₹2,000.

The unit engaged expert doctors from outside to attend on the patients and the fees were paid on the basis of the number of patients attended and time spent by them and on an average worked out to ₹ 10,000 per month in 2015.

The other expenses for the year were as under:	₹
Repairs and maintenance	3,600
Food supplied to patients	44,000
Janitor and other services for them	12,500
Laundry charges for their bed linen	28,000
Medicines supplied	35,000
Cost of oxygen, X-ray etc., other than directly borne for treatment of patients	54,000
General Administration charges allocated to the unit	49,550

Required:

- (i) If the unit recovered an overall amount of ₹100 per day on an average from each patient, what is the profit per patient day made by the unit in 2015.
- (ii) The unit wants to work on a budget for 2015-16, but the number of patients requiring intensive medical care is a very uncertain factor. Assuming that same revenue and expenses prevail in 2016, in the first instance, workout the number of patient days required by the unit to break even.

Answer:

(i) Number of Patient-days in 2015:

25 beds x 120 days	3,000
20 beds x 80 days	1,600
Extra bed-days	
(total hire charges of extra beds/ charges per bed per day = ₹2,000 ÷ ₹5)	<u>400</u>
	<u>5,000</u> patient-day

In order to calculate contribution, the profit per patient-day and the break-even point, it is necessary to classify the different costs into fixed and variable categories. It will be seen that while most of the items can be easily classified as fixed or variable, problem arises in respect of two items, viz. janitor and other services presumption that they are related to number of patient-days. On the other hand, cost of oxygen, X-ray etc., has been taken as a fixed cost since it has been stated that this cost is other than costs directly borne for treatment of patients.

Statement of Profit

	₹	₹
Income received (₹100 × 5,000 patient days)		₹5,00,000
<u>Variable Costs:</u>		
Food	44,000	
Janitor services	12,500	
Laundry	28,000	<u>2,41,500</u>
Contribution		2,58,500
<u>Fixed Costs:</u>		
Salaries (2 x ₹500 + 2 x ₹300 + 2 x ₹150) x 12	22,800	
Rent (₹5,000x12)	60,000	
Repairs and Maintenance	3,600	
General Administration	49,550	
Cost of oxygen, X-ray etc.	54,000	
		<u>1,89,950</u>
Profit		68,550

Profit per patient day = ₹ 68,550 ÷ 5,000 = ₹13.71

(ii) Total Contribution = 2,58,500

Total patient days = 5,000

Contribution per patient day = $\frac{2,58,500}{5000} = 51.7$

Break Even point = $\frac{\text{Fixed Cost}}{\text{Contribution per unit}} = \frac{1,89,950}{51.7} = 3,674$ patient days



12.9 RECONCILIATIONS OF FINANCIAL AND COST RECORDS

When the Cost and Financial accounts are kept separately, it is imperative that these should be reconciled, otherwise the Cost Accounts would not be reliable.

1. Items appearing only in financial accounts

The following items of income and expenditure are normally included in financial accounts and not in cost accounts. Their inclusion in cost accounts might lead to unwise managerial decisions. These items are:

(i) Income:

- (a) Profit on sale of assets
- (b) Interest received
- (c) Dividend received
- (d) Rent receivable
- (e) Share Transfer fees

(ii) Expenditure

- (a) Loss on sale of assets
- (b) Uninsured destruction of assets
- (c) Loss due to scrapping of plant and machinery
- (d) Preliminary expenses written off
- (e) Goodwill written off
- (f) Underwriting commission and debenture discount written off
- (g) Interest on mortgage and loans
- (h) Fines and penalties

(iii) Appropriation

- (a) Dividends
- (b) Reserves
- (c) Dividend equalization fund, Sinking, fund etc.

2. Items appearing only in cost accounts

There are some items which are included in cost accounts but not in financial account.

These are:

- (a) Notional interest on capital;
- (b) Notional rent on premises owned.

3. Under or over-absorption of overhead

In cost accounts overheads are charged to production at pre-determined rates where in financial accounts actual amount of overhead is charged, the difference gives rise under-or over-absorption; causing a difference in profits.

4. Different bases of stock valuation

In financial books, stocks are valued at cost or market price, whichever is lower. In cost books, however, stock of materials may be valued on FIFO or LIFO basis and work-in-progress may be valued at prime cost or works cost. Differences in store valuation may thus cause a difference between the two profits.

5. Depreciation

The amount of depreciation charge may be different in the two sets of books either because of the different methods of calculating depreciation or the rates adopted. In company accounts, for instance, the straight line method may be adopted whereas in financial accounts it may be the diminishing balance method.

Profit Reconciliation as per Cost and Financial Records forms part of Part D-2 of the Annexure to Cost Audit Report.

Illustration 1.

The financial profit and loss account for the year 2015-16 of a company shows a net profit of `26,28,000. During the course of cost audit, it was noticed that:

- (i) The company was engaged in trading activity by purchasing goods at `4,00,000 and selling it for `5,00,000 after incurring an expenditure of `25,000.
- (ii) Some old assets sold off at the end-end fetching a profit of `80,000
- (iii) A major overhaul of machinery was carried out at a cost of ₹4,00,000. And the next such overhaul will be done only after four years.
- (iv) Interest was received amounting to ₹1,50,000 from outside investments.
- (v) Work-in-progress valuation for financial accounts does not as a practice take into account factory overhead. Factory overhead was ₹1,85,000 in opening WIP and ₹3,15,000 in closing WIP.

Work out the profit as per Cost Accounts and briefly explain the adjustment, if any, carried out.

Answer:

Reconciliation Statement

			₹	₹
Profit as per Cost Accounts				27,53,000
Less:	1.	Proportionate Charge i.e., three-fourth for overhaul of machinery not provided in cost accounts	3,00,000	
	2.	Difference in the valuation of work-in-progress	<u>1,30,000</u>	4,30,000
Add:	1.	Trading profit not included in cost accounts	75,000	
	2.	Profit on sale of old assets	80,000	
	3.	Interest received on outside investment	<u>1,50,000</u>	<u>3,05,000</u>
Profit as per Financial Profit & Loss Account				<u>26,28,000</u>



Illustration 2.

The following figures are extracted from the Financial Accounts of BSL Ltd. for the year ended 31-03-2016:

	₹	₹
Sales (20,000 units)		50,00,000
Materials		20,00,000
Wages		10,00,000
Factory Overheads		9,00,000
Administrative Overheads		5,20,000
Selling and Distribution Overheads		3,60,000
Finished Goods (1,230 units)		3,00,000
Work-in-progress:		
Materials	60,000	
Labour	40,000	
Factory Overheads	<u>40,000</u>	1,40,000
Goodwill Written off		4,00,000
Interest paid on capital		40,000

In the costing records, Factory Overhead is charged at 100% of Wages, Administration Overhead 10% factory cost and Selling and Distribution Overhead at the rate of ₹ 20 per unit sold.

Prepare a statement reconciling the profit as per Cost Records with the profit as per Financial Records.

Answer:

BSL Ltd.

Profit & Loss Account

(For the year ended 31st March, 2016)

Dr.

Cr.

Particulars	₹ in Lakhs	Particulars	₹ in Lakhs
To Opening Stock	Nil	By Sales (20,000 units)	50,00,000
To Materials	20,000	By Closing Stock (1,230 units)	3,00,000
To Wages	10,00,000	By Work-in-progress	1,40,000
To Factory Overheads	9,00,000		
To Administrative Overheads	5,20,000		
To Selling & Distribution Overheads	3,60,000		
To Goodwill written off	4,00,000		
To Interest on Capital	40,000		
To Net Profit	2,20,000		
	54,40,000		54,40,000

Cost Profit & Loss Statement
(For the year ended 31st March, 2016)

Particulars	₹ in Lakhs
Materials	20,00,000
Wages	10,00,000
Prime Cost	30,00,000
Add: Factory Overhead @ 100% of wages	10,00,000
	40,00,000
Less: Closing Work-in-progress	1,40,000
Factory Cost (20,000 + 1,230) units	38,60,000
Administrative Overheads @ 10% of Factory Cost	3,86,000
	42,46,000
Less: Closing Stock of Finished Goods 1,230 units (See Note)	2,46,000
Cost of Production (20,000 units)	40,00,000
Selling & Distribution Overhead @ ₹20 per unit	4,00,000
Cost of Sales (20,000 units)	44,00,000
Sales Revenue (20,000 units)	50,00,000
Profit	6,00,000

Note: Cost of 21,230 units is ₹42,46,000. Therefore, the cost of one unit is ₹200. Hence the cost of 1,230 units is ₹2,46,000.

Alternatively: Administrative overheads could be excluded from the cost of production.

Reconciliation Statement

Particulars	₹	₹
Profit as per Cost Records		6,00,000
Add: Factory Overheads over-absorbed (₹ 10,00,000 – ₹ 9,00,000)	1,00,000	
Selling & Distribution Overhead Over-absorbed (₹ 4,00,000 – ₹ 3,60,000)	40,000	
Difference in the valuation of closing stock of finished goods (₹ 3,00,000 – ₹ 2,46,000)	54,000	1,94,000
		7,94,000
Less: Administrative Overhead Under-absorbed (₹ 5,20,000 – ₹ 3,86,000)		1,34,000
Goodwill written off relates to Financial Accounts		4,00,000
Interest on Capital	40,000	5,74,000
Profit as per Financial Accounts		2,20,000



Illustration 3.

The profit as per Financial A/c of DGL Cement Ltd. for the year 2015-16 was ₹ 1,34,27,516. The profit as per Cost Accounting records showed a different figure. You are required to prepare a reconciliation statement and arrive at a profit as per Cost Accounts. The following details were collected from Financial Accounting and Cost Accounting records.

	₹	₹
	Financial A/c	Cost A/c
Opening WIP	29,52,315	23,45,720
Opening Finished Goods	2,48,37,410	2,72,16,930
Closing WIP	41,72,635	36,35,345
Closing Finished Goods	3,67,51,410	4,15,24,148
Interest income from inter corporate deposits	6,14,250	-
Donations given	4,75,250	-
Loss on sale of Fixed Assets	1,04,148	-
Value of cement taken for own consumption	3,75,920	3,45,200
Cost of power drawn from own wind mill:		
At EB Tariff		48,58,415
At Cost	34,10,420	

Answer :

Sl. No.	Particulars	Current Year
1	Profit or Loss as per Cost Accounting Records	1,43,76,472
2	Add: Incomes not considered in cost accounts:	
	(a) Interest income from inter corporate deposits	6,14,250
3	Less: Expenses not considered in cost accounts:	
	(a) Loss on sale of Fixed Asset	1,04,148
	(b) Donations not considered in Cost Accounts	4,75,250
4	Add: Diff. in value of cement taken for own consumption	30,720
	Add: Diff. in valuation of wind mill power	14,47,995
	Less: Difference in stock valuation	24,62,523
5	Profit or Loss as per Financial Accounts	1,34,27,516

Illustration 4.

Abridged Cost Statement & Profit Reconciliation Statement

XYZ Ltd a Power Generation Company showing its Profit and Loss Statement as below.

Statement of Profit and Loss for the year ended 31st March 2016

Sl. No.	Particulars	For the year ended 31-03-2016
I	Revenue from operation	8,28,000.00
II	Other Income	42,200.00
III	Total Revenue (I+II)	8,70,200.00
IV	Expenses :	
	a) Cost of Material Consumption	6,10,700.00
	b) Cost of utilities	35,000.00
	c) Employee cost	41,800.00
	d) Finance Cost	50,220.00
	e) Depreciation and Amortisation Expenses	25,100.00
	f) Other Expenses	54,700.00
	g) Interest and Financial Charges	5,000.00
V	Total Expenses (a to g)	8,22,520.00
VI	Profit Before Exceptional Items And Tax (III-V)	47,680.00
VII	Exceptional Items	30,000.00
VIII	Profit after Exceptional item (VI-VII)	17,680.00

On review of the Financial Statement, following information's are obtained.

- (I) Cost of Material includes of ₹ 29,325 for Prior period adjustment
- (II) Employee Exp. Includes -
- Employee Exp. of ₹ 3,280 includes arrear salary for earlier year.
 - Employee Exp. of ₹ 2,100 for VRS expenses.
- (III) Other Expenses includes -
- Rebate to Consumer of ₹ 2,056
 - Repair and Maintenance of ₹ 18,012
 - Corporate Social Responsibility of ₹ 5,118
 - Demurrage Charges of ₹ 1,998
 - Commission on Sale of Scrap of ₹ 1,000
- (IV) Other Income includes -
- Sale of Scrap of ₹ 12,200
 - Sale of Fly Ash of ₹ 20,480
 - Profit on Sale of Fixed Assets of ₹ 9,520

Actual Production and Sales Quantity - 1,80,000

Prepare Cost Sheet And Reconciliation Statement For the Financial 2015-16

**Answer:**

Name of the Company: XYZ Power Generation Corporation Ltd.

Financial Year : 2015-16

PART-B**2. ABRIDGED COST STATEMENTO**

Name of Product		Thermal Electricity	
CETA heading		2716	
Unit of Measure		MU	
Year	Production	Other Adjustments	Quantity Sold
Current Year	1,80,000.00	-	1,80,000.00
		Current Year	
Sl. No.	Particulars	Amount in Rupees	Rate per Unit (₹)
1	Materials Consumed (Working Note-I)	5,81,375.00	3.23
2	Cost of Utilities	35,000.00	0.19
3	Direct Employees Cost (Working Note-II)	37,120.00	0.21
4	Repairs & Maintenance	18,012.00	0.10
5	Depreciation/Amortization	25,100.00	0.14
6	Other Expenses (Working Note-III)	21,516.00	0.15
7	Total (1 to 6)	7,18,123.00	3.87
8	Administrative Overheads	50,220.00	0.28
9	Cost of Sales before Interest (7 + 8)	7,73,343.00	4.15
10	Interest and Financial charges	5,000.00	0.03
11	Cost of Sales (9 + 10)	7,78,343.00	4.18
12	Net Sales Realization (Net of Taxes and Duties)	8,28,000.00	4.60
13	Margin Profit/(Loss) as per Cost Accounts (12-11)	49657.00	0.45

Note:

1. Out of Total Voluntary Retirement payment, only 1/3 charge has been considered as Cost and balance 2/3 charge as deferred expenses to be considered in subsequent years and considered Non-cost for the year .
2. It is assumed that the full amount of Exceptional items are Non-Cost in nature. So, shown in reconciliation statement.

Working Note I : Calculation of Material Consumed

Cost of Material as per P/L Statement	6,10,700.00
Less- Prior period of Material Cost	29,325.00
Charge to Cost	5,81,375.00

Working Note II : Calculation of Employee Cost

Employee cost as per profit and Loss Statement	41,800.00
Less: Voluntary Retirement Scheme (Note - 1)	1,400.00
Less: Arrear Salary for Prior period	3,280.00
Charge to Cost	37,120.00

Working Note III : Calculation of Other Expenses

Other Expenses as per P/L A/c	54,700.00
Less: (a) Rebate to Consumer	2,056.00
(b) Repair and Maintenance	18,012.00
(c) Corporate Social Responsibility	5,118.00
(d) Demurrage Charges	1,998.00
(e) Commission on Sale of Scrap	1,000.00
Charge to Cost	26,516.00

SECTION A

Objective Questions

1. Fill in the blanks: (Answer in bracket)

- (i) Cost Audit was initially introduced in the year ————— .(1965)
- (ii) According to CAS 8 on Utilities the cost of maintaining stand-by utilities is ————— cost. (**committed**)
- (iii) Efficiency audit ensures ————— return on Capital Employed.(**optimum**)
- (iv) Equalized transportation cost means ————— transportation cost incurred during a specified period. (**average**)
- (v) Value Addition is the difference between ————— and the cost of bought out materials and services. (**net output value**)
- (vi) CAS 5 deals with ————— (**equalized cost of transportation**).
- (vii) ————— ensures that every rupee invested in capital or other fields gives optimum returns. (**Efficiency**)
- (viii) Variances due to abnormal reasons ————— form part of cost. (**will not**. Note: This is as per Generally Accepted Cost Accounting Principles.)
- (ix) XBRL is a language based on ————— (**XML family of languages**)
- (x) Costing Taxonomy is best defined as a ————— (**dictionary**)

2. State whether following statements are “True” or “False” with reasoning/ justification for your answer. (Answer within bracket)

- (i) Cost Audit is synonymous with efficiency audit. (**True. The Cost audit Report mainly comment on the efficiency of the company namely, utilization aspect of the factors of production**)
- (ii) Donations given to Charitable Institutions should not form part of Cost Accounts.(**True. Expenses on account of donations is purely financial in nature, hence excluded from Cost Accounts.**)
- (iii) Market research cost is not a part of Research and Development Cost.(**True. Market Research is part of Selling and Distribution Cost.**)
- (iv) CAS 9 deals with indirect material cost.(**False. CAS 9 deals with packing material cost.**)
- (v) Part B of the Annexure to Cost Audit Report relates to service sector. (**False. Part B of the Annexure to Cost Audit Report relates to Manufacturing sector**)
- (vi) Quantitative Information as part of Annexure to Cost Audit Report needs to be shown for Current Year only.(**False. Quantitative Information as part of Annexure to Cost Audit Report needs to be shown for Current Year and Previous Year.**)
- (vii) Excess recovery of Excise is income purely financial in nature. (**The statement is True.**)
- (viii) Profit reconciliation for the company as a whole is dealt in Part C of the Annexure to Cost Audit Report. (**False. Profit reconciliation for the company as a whole is dealt in Part D of the Annexure to Cost Audit Report.**)
- (ix) CAS 24 deals with Treatment of Revenue in Cost Statements.(**True**)
- (x) As per Companies (Cost Records and Audit) Rules, 2014, Profit Reconciliation (for company as a whole information is required to be given for Current Year and Previous 2 years. (**False. Information need to be given for Current Year and Previous Year only**)

Short Questions

(i) What you understand by “True and Fair Cost of Production.”?

Ans: The concept of “True and Fair Cost of Production” is used in the context of cost audit wherein the cost auditor has to state whether in his opinion the company’s cost accounting records have been kept so as to give a true and fair view of the cost of production, processing and marketing of the product.

(ii) What constitutes the cost records under Rule 2(e)?

Ans: Cost records “means books of account and other records relating to utilization 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.

The Act here refers to The Companies Act 2013. Rule refer to Cost (Records and Audit) Rule, 2014.

(iii) Define Cost Auditor.

Ans: Rule 2(c) of the Companies (Cost Records and Audit) Rules, 2014 means a Cost Accountant in practice, as defined in clause (b), who is appointed by the Board.

(iv) How would you treat demurrage charges as per CAS 15?

Ans: As per CAS 15 relating to Selling and Distribution overheads, any demurrage or detention charges, or penalty levied by transportation or other authorities in respect of distribution activity shall not form part of the Selling and Distribution overhead.

(v) How is cost computed if service is provided by contractors as per CAS 13?

Ans: Cost of services rendered by contractors within the facilities of the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources provided to the contractors for such services.

Cost of services rendered by contractors at their premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of resources provided to the contractors.

(vi) How would you treat Employee share options under Generally Accepted Cost Accounting Principles ?

Ans: Cost of employee share options is treated as part of employee cost provided the same is not a notional cost and involves an actual cash outlay.

(vii) What is XBRL?

Ans: XBRL (eXtensible Business Reporting Language) is a language based on XML (Extensible Markup Language) family of languages. It is an open standards-based reporting system that is built to accommodate the electronic preparation and exchange of business reports around the world using internet as a medium. It has been defined specifically to meet the requirements of business and financial information.

(viii) How would you treat the abnormal cost?

Ans: The abnormal cost must be excluded from computation of Cost .

(ix) How will you treat an item of Direct Expenses that does not meet the test of materiality as per CAS 10?

Ans: If an item of Direct Expenses does not meet the test of materiality, it can be treated as part of overheads.

(x) Can a Cost Accountant who is appointed as the Concurrent Auditor of a company be appointed as Cost Auditor of the same company?

Ans: A Concurrent Auditor may be viewed as a person holding an office of profit of the company and so cannot be appointed as Cost Auditor of the same company.

Self – Examination Questions

(1) What are the salient features of Cost Audit?

(2) Can you consider "Cost Audit" as (a) Management Audit (b) Social Audit (c) Propriety Audit?

(3) In dealing with the financial position of a company as per Part D(4) of the Annexure to the Cost audit Report, state your opinion regarding:

(i) Is the Capital Employed to be computed as at the beginning of the accounting period or at the end of the accounting period or average of both?

(ii) Should investments like National Savings Certificates deposited with Government authorities for Sales Tax, Excise etc. as security be treated as investments outside the business?

(iii) How is 'net worth' defined?

(4) In spite of increase turnover continuously for three years, a company has started incurring cash losses, and has become sick. Is it possible to identify and pinpoint the factors which have led to this situation from Cost Audit Report? Explain quoting the relevant paragraphs in the Annexure to the Report.

(5) How would you treat the following as per CAS 7 related to Employee Cost?

(i) Recruitment cost.

(ii) Overtime premium

(iii) Separation cost due to voluntary retirement, retrenchment, termination etc.

(iv) Idle time cost

(7) How would you assign administrative overheads as per CAS 11?

(8) What do you understand by GACAP?

(9) What is the benefit of having cost related data in XBRL format?

(10) What is Cost Auditing Standard (104) about? What are the Audit Risks referred in this standard?



SECTION B

Objective Questions

1. State whether following statements are True or False. Justify your answer.

- (i) There are no fixed items of evidence to be checked by Management Auditor. (True. **A Management Auditor has to rely more on his experience and acumen to identify areas of review.**)
- (ii) Dumping is an 'illegal' practice. (False. **Dumping is an 'unfair' practice.**)
- (iii) Assurance engagements involve three separate parties. (True. **The parties are a public accountant in practice, a responsible party and intended users.**)
- (iv) The main emphasis of Management Audit is problem identification rather than problem solving. (True. **Management Audit pinpoints the areas requiring attention of management, it evaluates the existence of well defined objectives, it seeks to review appraise and evaluate the corporate plans and policies based on certain standards of objectivity.**)
- (v) Zero base budget(ZBB) system was modeled by Peter A. Woodcock. (False. **ZBB System was modeled by peter A. Phyrh.**)
- (vi) There is no need for Management Audit Programme. (False. **Management Audit Programme is prerequisite to conduct audit and help the auditor to cover the entire area of function thoroughly.**)
- (vii) Management Audit is voluntary (True. **It is undertaken by Management as it helps in effective functioning of every area of operations coming under management perview.**)
- (viii) Important point in Corporate planning is SWOT analysis. (True. **A SWOT-strengths, weaknesses, opportunities and threats analysis can help identify and understand key issues affecting the business**)
- (ix) Management Audit Report is to be submitted to Cost Audit Branch. (False. **Management Audit Report is to be presented to the Management.**)
- (x) The concept of Financial Audit was developed by T. G Rose. (False. **T. G. Rose developed the concept of Management Audit as a logical system of evaluating the quality of Management.**)

2. Fill in the blanks with appropriate word/words. (Answer given in bold)

- (i) Management audit requires _____ approach. (**inter-disciplinary**)
- (ii) ISO 9000 certification is an _____ service. (**assurance**)
- (iii) Corporate objectives represent the _____ for the organization as laid down by itself. (**charter**.)
- (iv) The two techniques available for Social Cost Benefit Analysis are _____ and _____. (**UNIDO, Little and Mirrlee's Approach.**)
- (iv) Energy audit means the monitoring of energy efficiency of different _____ and _____ in a plant. (**equipment, process**)
- (v) The main emphasis of Management Audit is problem _____ rather than problem _____. (**identification, solving**)
- (vi) Management Audit can be a _____ for managerial control. (**potent tool**)
- (vii) _____ cannot be delegated. (**Responsibility**)
- (viii) A corporate development audit is an _____ study of organisation's capabilities. (**independent, objective**)

- (ix) "Personal Management" is that part of management function which is primarily concerned with the _____ within an organization. (**human relationship**)
- (x) _____ is the evaluation of every resources declared in the industry. (**Productivity Analysis.**)

Short Questions

- (1) How should a Cost Auditor evaluate MIS of an organization?

Ans: A Cost Auditor should take into consideration the following aspects while evaluating MIS of an organization:

- (I) Content, quality and source of information;
- (II) Flow of information
- (III) Correlation of information in decision areas.

- (2) What is productivity audit?

Ans: Productivity audit is the process of monitoring and evaluating organizational practices to determine whether functions, programmes, and organization itself are utilizing resources effectively and efficiently so as to accomplish objectives.

- (3) What do you understand by environment audit?

Ans: Environment Audit is a systematic , documented, periodic and objective review by related entities , of facility operations and practice related to meeting environment requirements.

- (4) A Management Audit team should be multidimensional. Discuss.

Ans: As a management auditor is concerned with all aspects of business and the organization , ranging from manufacture to marketing and finance , the management audit team should be multidisciplinary to make multidimensional approach to audit function.

- (5) What are the Management Audit Questionnaires?

Ans: A management audit questionnaire is an important tool for conducting the management audit. It is through these questionnaires that the auditors make an inquiry into important facts by measuring current performance. Such questionnaires aim at a comprehensive and constructive examination of an organisation's management and its assigned tasks.

- (6) What is Energy Audit?

Ans: Energy auditing is defined as an activity that serves the purposes of assessing energy use pattern of a factory or energy consuming equipment and identifying energy saving opportunities.

- (7) Write short not on "Customer Costing in Service Sector".

Ans: For customer costing purpose, the cost are divided into following categories. These are:

- (i) *Customer specific costs*-Like the cost of express conveyer to a client/customer who requests oversight delivery of some important document.
- (ii) *Customer line categories*- These are the costs which are broken into the broad categories of customers and not individual customer.
- (iii) *Company costs*- Those costs which are not allocated to either customer line or individual customers but charge to company. The example is the cost of advertisement to promote sale of service.

- (8) What is "Consumer Services " Audit?

Ans: Consumer Service Audit is based on the philosophy that role of business should be quality of life through its contribution in terms of better product quality and services.



(9) What do you understand by Corporate Strategy?

Ans: Corporate strategy or policy is the strategy that determines the means for utilizing resources in the areas of production, finance, research and development, personnel, and marketing to reach the Corporate Objectives.

(10) What is "Personnel Management"?

Ans: "Personnel Management" is that part of the management function which is primarily concerned with the human relationships within an organization. Its objective is essentially the maintenance of those relationships, which enable all those engaged in the undertaking to make their maximum personal contribution to the effective working of that undertaking.

Self Examination Questions

- (1) State in brief the behavioural aspects encountered in the management audit. Suggest the ways to solve them.
- (2) The newly appointed Chief Executive of a Company has asked you, as a Management Auditor, to give him a factual report, as to why his staffs are by and large demoralized.
- (3) A company engaged in manufacturing of chemicals is consistently recording higher sales turnover, but declining net profits since the last 5 years. As a management auditor appointed to find out the reasons for the same, what are the points you would investigate ?
- (4) ADC Bank, a scheduled bank has received an application from an export company seeking sanction of a term loan to expand the existing sea food processing plant. The General Manager, (Advances) approaches you to conduct a thorough investigation of this limited company and submit a project report.
List out the points you will cover in your investigation before submitting your report to the General Manager.
- (5) What do you understand by "Corporate Services Audit"? Describe the areas of Corporate Services Audit, the scrutiny thereof and the evaluation criteria used in such audit.
- (6) Describe the steps involved and the measures used in productivity audit.
- (7) You have been appointed to carry out Management-cum-Operational Audit of a PQR Ltd. State whether the use of quantitative ratios is more effective than the use of financial ratios to gain real insight into the financial and cost statements.
- (8) You are appointed by Mr. K who wants to join DEF & Co, partnership firm as an investigating accountant. List out the steps involved in conducting the same.
- (9) The term 'image' in relation to a company refers to how it is perceived by the public at large. Keeping this in mind how would a management auditor approach to evaluate the corporate image of accompany? Discuss the techniques available to the management auditor to evaluate the corporate image.
- (10) What are the basis differences between 'Management Audit' and 'Operational Audit'?

SECTION C

Objective Questions

1. State whether following statements are True or False. Justify your answer.

- (i) Internal Auditing is one time activity. **(False. It is a continuous and systematic process of examining and reporting the operations and records of a concern.)**
- (ii) Internal Audit can be performed by employees of an organization. **(True. Internal audit is a management tool performed by employees of the organization or external agencies specially assigned for this purpose.)**
- (iii) Internal Audit is not discussed in Companies Act 2013 **(False. Internal Audit is discussed in Section 138 of Companies Act 2013.)**
- (iv) Internal audit is applicable for every listed company. **(True. As per Rule 13 Of Companies (Accounts) Rules, 2014, every listed company has to appoint internal auditor.)**
- (v) Internal control system can be classified in three types. **(True. Preventive Control, Detective Control and Corrective Control.)**
- (vi) There is no requirement of Audit Working Papers while conducting audit and they only result in loss of time. **(False. Audit working papers are the record of the planning and execution of the audit engagement. Auditors retain a set of working papers for each audit engagement for each year.)**
- (vii) Audit working papers are property of the company. **(False. Working papers are the property of the auditor.)**
- (viii) Co-operative auditor to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society while conducting internal audit. **(True. Section 17 (2) of the Co-operative Societies Act, 1912 specifically requires the auditor to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society.)**
- (ix) Internal control is very essential in maintenance of Hotel Accounts. **(True. Pilferage is one of the greatest problems in any hotel and it is extremely important to have a proper internal control to minimize the leakage.)**
- (x) Every listed Company should have Audit Committee. **(True. The Board of directors of every listed company and the certain classes of companies, as prescribed under Rule 6 of Companies (Meetings of Board and its powers) Rules, 2014 shall constitute an Audit Committee.)**

2. Fill in the blanks with appropriate word/words. (Answer given in bold)

- (i) _____ of Companies Act 2013 deals with Internal Audit. **(Section 138)**
- (ii) An audit programme is a _____ plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. **(detailed)**
- (iii) An audit report is a _____ where internal audit summarizes its work on an audit and reports its findings and recommendations based on that work. **(formal document)**
- (iv) Section 17 (2) of the _____ specifically requires the auditor to conduct an examination of the overdue debts, if any, and a valuation of the assets and liabilities of the society. **(Co-operative Societies Act, 1912)**
- (v) Field Balance Sheet Approach to audit can be applied in audit of _____ **(Self-help Group)**
- (vi) The Local bodies in India are broadly classified into _____ categories. **(two)**



- (vii) Audit of government ————— is one of the major components of government audit conducted by the office of C & AG. (**Expenditure**)
- (viii) Under 'propriety audit', the auditors try to bring out cases of ————— expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. (**improper, avoidable, or in fructuous**)
- (ix) Statutory corporations created ————— statutes (**specific**)
- (x) The auditor of a government company is appointed by the ————— (**C&AG**)

3. Short Questions.

(1) What do you understand by Audit Report?

Ans: An audit report is a formal document where internal audit summarizes its work on an audit and reports its findings and recommendations based on that work.

Audit report will be an indicator of the usefulness of the internal audit functioning in the organization.

(2) Which section of Companies Act deals with Internal Audit?

Ans: Section 138 of the Companies Act 2013 deals with provisions of Internal Audit.

(3) What is Audit programme?

Ans: An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit.

(4) State the functions of summary report to Top Management.

Ans: Summary reports to management usually would have two distinct functions – (i) They would tell what the internal audit department has accomplished when compared to what was planned. (ii) They would show conclusions of the auditors in a summarised form.

(5) How do you classify Local Bodies?

Ans: The Local bodies in India are broadly classified into two categories. The local bodies constituted for local planning, development and administration in the rural areas are referred as Rural Local Bodies (Panchayats) and the local bodies, which are constituted for local planning, development and administration in the urban areas are referred as Urban Local Bodies (Municipalities).

(6) What do you understand by Propriety Audit in the Context of Government Audit.

Ans: Under 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.

(7) How are NGO(s) incorporated?

Ans: Non-Governmental Organisations are generally incorporated as societies under the Societies Registration, Act, 1860 or as a trust under the India Trust Act, 1882, or under any other law corresponding to these Acts enforced in any part of India. NGO's can also be incorporated as a company under section 8 of the Companies Act, 2013.

(8) What is the first step in audit of Educational Institutions?

Ans: To examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

(9) What are the two types of Audit files?

Ans: In case of recurring audits, some working papers files may be classified into permanent audit files and current audit files: while the former is updated with the Information of continuing importance, the latter contains information relating to audit of a single period.

(10) Who can be appointed as Internal Auditor as per the Companies Act, 2013?

Ans: AS per Section 138 of the Companies Act , 2013 an internal auditor, shall either be a chartered accountant or a **cost accountant**, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

4. Self Examination Questions:

- (1) Draft an internal control questionnaire for 'Account Receivables'.
- (2) "Much good work gets lost because the auditor's report fails to evoke the interest of the reader". Discuss the above statement in the context of the report of the operational auditor.
- (3) You have been appointed as Internal Auditor of FBG Ltd. a Non-Banking Equipment Leasing Finance Company. What are the special points would you keep in mind in the audit of a Non-Banking Equipment Leasing Finance Company?
- (4) As an internal auditor of DEF Ltd. the Managing Director has asked you to enquire into the causes of abnormal wastage of raw materials during the month of September, 2016.

The wastage percentages are as follows:

June, 2016	1.3%
July, 2016	1.1%
August, 2016	1.4%
September, 2016	3.8%

How will you proceed to carry out the Assignment?

- (5) Briefly explain the objectives of Operational Audit.
- (6) Draft an internal audit programme for a NGO.
- (7) Describe the role of C&AG in the Audit of a Government company.
- (8) You have been appointed as an internal auditor for M/s KBC Ltd which is a large manufacturing concern. You are asked to verify whether there are adequate records for identification and value of Plant and Machinery, tools and dies and whether any of these items have become obsolescent and not in use. Draft a suitable audit programme for the above.
- (9) Give an "Audit programme" as an Internal Auditor of Wage Audit.
- (10) Internal Audit is an independent appraisal activity within an organisation for review of operations as a service to management. Discuss.