GUIDANCE NOTE ON INTERNAL AUDIT OF COST RECORDS

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CHAPTER –1 INTRODUCTION

History of Internal Auditing

The Internal Auditing profession evolved steadily with the progress of management science after World War II. It is conceptually similar in many ways to financial auditing by public accounting firms, quality assurance and banking compliance activities. While some of the audit technique underlying internal auditing is derived from management consulting and public accounting professions, the theory of internal auditing was conceived primarily by Lawrence Sawyer (1911-2002), often referred to as "the father of modern internal auditing"; and the current philosophy, theory and practice of modern internal auditing as defined by the International Professional Practices Framework (IPPF) of the Institute of Internal Auditors owes much to Sawyer's vision. With the implementation in the United States of the Sarbanes-Oxley Act of 2002, the profession's exposure and value was enhanced, as many internal auditors possessed the skills required to help companies meet the requirements of the law. However, the focus by internal audit departments of publicly traded companies on SOX related financial policy and procedures derailed progress made by the profession in the late 20th century toward Larry Sawyer's vision for internal audit. Beginning in about 2010, once again advocacy for the broader role of internal auditing in the corporate arena has started.

Organizational Independence

While internal auditors are not independent of the companies that employ them, independence and objectivity are cornerstones of any internal audit system. From the view point of independence, it is advisable to have external agency to be appointed for the function. Even if the company intends to carry out the internal auditing function departmentally the reporting may be entrusted not to the internal management of the company but to "outsiders" like Audit Committee. Internal auditors may report to the management for administrative purposes but functional reporting must be separated.

The required organizational independence from management enables unrestricted evaluation of management activities and personnel and allows internal auditors to perform their role effectively. Although internal auditors may be employed by the company either internal or external professionals, the primary customer of internal audit activity is the entity charged with oversight of management's activities. This is typically the Audit Committee, a sub-committee of the Board of Directors. Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board: Approving the internal audit charter; Approving the risk based internal audit plan; Approving the internal audit budget and resource plan; Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters; Approving decisions regarding the appointment and removal of the chief audit executive; Approving the remuneration of the chief audit executive; and Making appropriate inquiries of management and the chief audit executive to determine whether there is inappropriate scope or resource limitations.

'Cost' is a measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services.Cost object means an activity, contract, cost centre, customer, product, process, project, service or any other object for which costs are ascertained. Cost accounting is the process of identification, classification, measurement, and assignment of costs to various cost objects.

To ascertain true cost of any cost object, it is necessary to consider three dimensional data viz. quantity, rate & value vis-à-vis the financial accounting system that largely require one dimensional data viz. values only, irrespective of its place of incidence and behaviour. Further, cost accounting entails many other additional features such as use of the concept of capacity, occurrence of normal or abnormal events, earning of various non-operational revenues, incurrence of various non-cost expenses, fixed or variable nature of costs, normal or abnormal wastages/losses, etc. that is largely ignored in the financial accounting system. Further, the cost accounting system also requires distinct identification of products/services, product lines, cost centers, etc. Therefore, cost accounting system would require creation of additional set of registers, books, records etc.

Internal auditing is 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.

Internal audits, till few years back, were focusing on to provide assurance on the 'true and fair' view of financial statements, mainly to support the statutory auditors on the adequacy and effectiveness of internal controls [the internal accounting controls] within the organization. Internal auditors were also looking into the compliance areas. However, the internal audit gradually shifted its focus on the operational audit and later to corporate governance and risk management. In the current complex business models, role of internal auditor has more shifted to the management or proprietary or strategic audit. They are now more concerned with the performance audit. Internal auditing activity is now designed to add value to and improve an organization's operations. This shift in the role & focus of the internal audit has expanded their domain from financial data to cost & operational data.

Thus the scope of internal auditing within an organization is broad.It may be seen that the Companies (Cost Records and Audit) Rules, 2014 require the Cost Auditor to certify whether or not, based on his opinion, the company has adequate system of internal audit of cost records which to his opinion is commensurate to its nature and size of its business.

Since incorporation of Institute of Internal Auditors in 1941, lot of research has been carried out in the field of internal audit and large number of published literature is available in the public domain. But it is mainly covering areas like financial accounting, internal financial controls, risk management, etc. Very less has so far been written about the internal audit of cost records. Therefore, the Institute felt it important to issue a guidance material on this subject.

This Guidance Note is intended to help the Cost Accountants in practice, members and all other stakeholders for better understanding of the provisions relating to Internal Audit of Cost Records.

1. Definition

As per Companies Act, 2013 2(*12*) "book and paper" and "book or paper" include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form;

As per Companies Act, 2013 Section 2(13) "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;

2. Meaning of Books of Account

The meaning of books of account in the common parlance is "the place where all financial information for a person or business is collected."

A US legal dictionary explains the term as follows –

A book account means:

(1) A detailed statement of credits and debits between persons;

(2) An account or record of credit and debits in a book;

(3) A book containing a detailed history of an entity's business transactions;

(4) A record of goods sold or services rendered; or

(5) A statement in detail of the transaction between persons.

3. Income Tax Act, 1961 Sec. 2 (22AA)

Passing of the Information Technology Act, 2000 necessitated the insertion of definition for "Document" in the I-T Act, 1961. A new Section 2 (22AA) was brought in to define "document".

(22AA) "document" includes an electronic record as defined in clause (t) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

2 (1) (t) —electronic record means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche;

Thus the definition of books of account is sufficiently widened under various statute to include electronic record as a part of document or books of account.

4. Case Law - Madras High Court in CIT vs Taj Borewells (291 ITR 232 Madras):

Taj Borewells did not maintain books of account since the gross receipts were below Rs. 5 lakh. The partners of the firm had brought in Rs. 5,25,000 as investments. The assessing officer (AO) did not accept the claim about the investment by partners. He concluded that the amount represented the undisclosed income of the firm and added the same under Section 68 of the I-T Act. The Income Tax Appellate Tribunal (ITAT) annulled the addition and the department took up the matter in appeal before the Madras High Court. The Madras High Court quoted with approval the definition given in P Ramanatha Aiyer's Advanced Law Lexicon. The definition in the Lexicon appears wider than the in the tax law. A book containing a monetary transaction, according to the Lexicon, would attract the definition of books of accounts under the Indian Evidence Act.

The Hon. High Court observed that books of account will mean any book which formed an integral part of a system of book keeping employed in any particular business and included the ledger and the books of original entry. After explaining the object behind the making of a P&L account, the Hon. Court observed that the balance-sheet listing the assets and liabilities and equity accounts of the company is prepared "as on" a particular day and the accounts reflected the balances that existed at the close of business on that day. The Hon. Court took note of earlier precedents on the subject and held:

"We can safely conclude that the profit and loss account and the balance-sheet are not books of account as contemplated under the provisions of the Act."

The profit and loss account or the balance sheet drawn by the company is extract and end result based upon and drawn from the books of account maintained by the entity. These statements themselves cannot be constituted as books of account though they are an integral part thereof. A synonym can be observed in case of cost statements which are the end result and based on the various cost records maintained by the entity. Compilation of cost statements on the basis of financial statements just by identifying items of reconciliation is unhealthy practice and defeats the very purpose of maintenance of cost records. The entity should maintain various records contemplated under the statute and cost statement should be drawn on the basis of these records.

5. As per rule 2 (e) of the Companies (cost records and audit) Second Amendment Rules, 2017, "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;

Books of account as defined in sec 2(12) and 2(13) have a wider connotations and it encompasses various accounting records relating to the various transactions which take place in running of the business. It may be mentioned that different types of business transactions take place and the recording thereof is documented in various forms of records whether in paper format or in electronic format. Books of account is a common database which gets generated while carrying out any business and the same database can be used for various purposes such as financial accounting , cost accounting , statistical reporting , quantitative reporting and so on. It may be a misnomer to say that books of account pertain only to financial accounts of the company. Clause (iv) of sec 2(13) of Companies Act, 2013 specifically provides for records relating to cost. Nevertheless these records are useful both for financial accounts and cost accounts and one can always use the basic data generated through these records for different purposes.

An internal cost auditor would be required to conduct the checking and verifications of all books of account contemplated under the provisions of the Companies Act, 2013. However, it may be mentioned that his counterpart, the internal auditor of financial accounts is simultaneously going through the Books of Account maintained by the company and the internal cost auditor can place reliance on his professional colleague. The reports submitted by the internal auditors of financial records can be reviewed by the internal cost auditor to place his reliance as regards the sufficiency and accuracy of these records and reports. The intention is not to duplicate the processes already carried out by the internal financial auditors. It will be more advisable for the internal cost auditor to go into details of such records which are normally not thoroughly covered by the internal financial auditor.

In particular, the internal auditor of cost records should focus on the following aspects of various books of account.

(i) propriety and reasonableness of money expended by the company.

(ii) completeness and appropriateness of the incomes / receipts by the company

(iii) propriety and reasonableness of money expended for purchases by the company both of revenue nature and capital nature.

(iv) completeness and appropriateness of the sales revenue earned by the company

(v) propriety and reasonableness of assets acquired and its accounting and use over the period

(vi) creation of liabilities with corresponding benefit accruing to the company

(vii) proper accounting and treatment of various of costs

CHAPTER –3 INTERNAL AUDIT

3.1 Legal Provisions

3.1.1 Introduction

The compliance with the laws of the home country as well as the laws of the foreign country for existence of businesses in India and abroad is a critical factor. As per the legal obligation / requirement under different statutes in India and abroad, a Company shall have internal audit of its accounts carried out, at such interval and in such manner as may be specified.

3.1.2 MAOCARO (1975): Recognizing the significance of internal audit, it was first made mandatory for a particular set of companies vide the Manufacturing and Other Companies (Auditor Report) Order, 1975 that required the auditor to certify whether the company has an internal audit system commensurate with its size and nature of its business. And also, whether there is an adequate internal control procedure commensurate with the size of the company and the nature of its business, for the purchase of stores, raw materials including components, plant and machinery, equipment and other assets, and for the sale of goods.

At that time, internal audit was perceived to be subservient to statutory auditors having prime focus on the audit, finance and internal controls. However, with the evolution of internal audit in other advanced economies, the scope in India too changed.

On August 30, 2013, the Central Government notified the Companies Act, 2013 (18 of 2013). By virtue of this notification, the Companies Act, 1956 stood repealed.

3.1.3 The Companies Act, 2013, Section 138 – Internal Audit

(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 report to the Board.

3.1.4 Companies (Accounts) Rules, 2014 are issued by the Central Government as per the powers under sec 138(2). The class or classes of companies have been defined under Rule 13.

Rule 13, Companies are required to appoint internal auditor:

(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 capital 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.

Explanation – For the purpose of this rule –

(i) the internal auditor may or may not be an employee of the company;

(ii) the term "Chartered Accountant" or "Cost Accountant" shall mean a "Chartered Accountant" or a "Cost Accountant", as the case may be, whether engaged in practice or not.

(2) The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

The reading of Section 138 and Companies (Accounts) Rules, 2014 prescribe mandatory internal audit to companies meeting the criteria mentioned therein. However, it may be noted that the scope of internal audit of cost records is much wider. It is independent of and also in addition to the internal audit of financial records. **The companies which may not get covered under the internal audit provisions may get covered under the internal audit of cost records.**

Under the Companies (Cost Records and Audit) Rules, 2014, form CRA 3, the cost auditor has to certify the adequacy of the system of internal audit of cost records. The company fulfilling the criteria for mandatory cost audit may not be fulfilling the criteria for internal audit, but still such companies are required to have the system of internal audit of cost records. E.g. there is a private company having turnover of say 150 crores, subject to cost audit is required to carry out the internal audit of cost records whether it carries out or not the internal audit of financial records. (assuming it is not meeting the other conditions under the Companies (Accounts) Rules, 2014)

3.1.5. The Companies Act, 2013, Section 134 – Financial Statement, Boards Report etc.

The relevant subsections and clauses relating to internal audit are reproduced

The report by Board of Directors shall include -
Section 134, Sub-section 3, Clause (c) Directors Responsibility Statement

Section 134, Sub-section 3, Clause (n) states that the Board of Directors' Report would include a statement indicating development and implementation of risk management policy for the Company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the Company.

Section 134, Sub-section 5, The Directors' Responsibility Statement referred to in clause (c) of sub-section (3) shall state that—

(a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(d) the directors had prepared the annual accounts on a going concern basis; and

(e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively. Explanation.—For the purposes of this clause, the term "internal financial controls" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information;

(f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

Section 134, Sub-section 3 -The Companies Act, 2013 Section 134 (3) provides that *"There shall be attached to statements laid before a company in general meeting, a report by its Board of Directors…"*

Ministry of Corporate Affairs vide notification dated 31st march, 2014 has issued the Companies (Accounts) Rules, 2014 effective from 1st day of April, 2014. The said Rules have been amended and the Ministry of Corporate Affairs has issued notification on 3rd July, 2018 and has notified the Companies (Accounts) Amendment Rules, 2018.

The Companies (Accounts) Rules, 2014, in rule 8, matters to be included in Board's report are prescribed. Vide the Companies (Accounts) Amendment Rules, 2018 sub-rule (5), clause (ix) is inserted which reads as under,

"*(ix) a disclosure, as to whether maintenance of cost records as specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013, is* *required by the Company and accordingly such accounts and records are made and maintained,"*

Significance of the Companies (Accounts) Amendment Rules, 2018

The responsibility is now also casted on the Board of Directors to certify whether maintenance of cost records has been prescribed by the central Government to the company and to express their assurance to the stakeholders that such cost accounts and records have been "made and maintained".

3.1.6 The Companies Act, 2013, Section 144 – Auditor not to render certain services

An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of directors or the Audit Committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:—

(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; and
(i) any other kind of services as may be prescribed by the Central Government.

The Companies Act, 2013 specifically prohibits the statutory cost auditors from rendering services in the nature of accounting and book keeping services, internal audit services or management services. The compilation or preparation of records and statements is not contemplated to be carried out by the statutory cost auditors. The areas which can fall under the scope of internal audit of cost records, thus can not be accepted while carrying out statutory cost audit of a company. It will be clear violation of the provisions of Companies Act, 2013. The intention of the statute is simple and clear that a statutory cost auditor need not indulge in certain areas which are "internal" to the management of the company to keep the independence of the statutory cost auditor.

3.1.7 The Companies Act, 2013, Section 177 – Audit Committee

Relevant clauses of Section 177 are reproduced below -

(4) Every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include—

> (i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;
>
> (ii) review and monitor the auditor's independence and performance, and effectiveness of audit process;
>
> (vii) evaluation of internal financial controls and risk management systems;

(5) 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.

Internal cost auditor, shall attend and participate at meetings of the Audit Committee of the company on the invitation. Section 177, bestows statutory duties on audit committee. The internal auditors, the internal cost auditors are important chains in the system to ensure financial controls, cost controls, risk management, performance and efficiency evaluation and enhancement and so on. The internal cost auditors have to act as eyes and ears of the audit committee.

3.1.8 Clause 49 of Listing Agreement: Corporate Governance (SCRA) In case of the listed companies as per the Clause 49 of Listing Agreement the audit committee should be 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.

3.1.9 Sarbanes Oxley Act of 2002:

The introduction of Sarbanes Oxley Act of 2002 marks a new era in the domain of internal audit. The act emphasis the need for strong internal audit function to meet the stringent corporate governance and internal control requirements. Sec.

302 and 404 provide for management assessment of internal controls and certifications thereof from CEO and CFO of the companies.

3.1.10 Under SEBI Circular No. MRD/DMS/Cir-29/2008, October 21, 2008 in partial modification of SEBI circular No. MIRSD/ DPSIII/ Cir-26/ 08 dated August 22, 2008 on the above subject, the SEBI has mandated that stock brokers/trading members/clearing members shall carry out complete internal audit on a half yearly basis by chartered accountants, company secretaries or cost and management accountants who are in practice and who do not have any conflict of interest.

3.1.11 Under Circular of SEBI No. SEBI/MIRSD/CRA/Cir-01/2010 dated January 06, 2010 Internal Audit for Credit Rating Agencies (CRAs) has been prescribed under Regulation 22 of the SEBI (Credit Rating Regulations), 1999, which shall be undertaken on a half yearly basis and shall be conducted by Chartered Accountants, Company Secretaries or Cost and Management Accountants who are in practice and who do not have any conflict of interest with the CRA.

3.1.12 Under IRDA (Investment) (Fourth Amendment) Regulations, 2008i.An Insurer having Assets under Management (AUM) not more than Rs.1000 Crore shall conduct a Quarterly Internal Audit to cover both Transactions and related Systems; ii. The Audit Report of the company shall clearly state the observation at transaction level and its impact, if any at System level. The Audit Report shall be based on Exception Reporting.

3.2 Definitions

3.2.1 An independent audit of the records internal to the entity that is aimed at evaluating the continuity, adequacy and performance of the system of internal controls of the entity in its various activities involving operations, administration, finance &accounting and compliance, with the view to ensure efficiency and effectiveness in the utilisation of resources and providing objective & reliable information for safeguarding the assets and interest of the entity, and management of risks.

3.2.2 Internal audit may also be defined as evaluation and analysis of a business operation. Internal audits are considered as a part of the overall system of internal control that is established in an organisation and is conducted by professional internal auditors. This gives the management an assurance concerning the control process in the organisation and helps detect inefficiencies or fraud early.

3.2.3 An internal audit is generally conducted with the aim to evaluate the effectiveness of internal control, the soundness of the financial system, efficiency of business processes and so on. Internal Auditing is an independent, assurance, objective and consulting activity that is formulated to add value to and improve a particular organisation's operations. Not just that, it also helps a company to accomplish its goals by bringing in a systematic and disciplined approach that evaluates and improves the effectiveness of an organisation's risk management, corporate governance and internal control processes.

3.2.4 The Chartered Institute of Management Accountants, UK (CIMA) defines Internal Audit as: 'An independent appraisal activity established within an organisation as a service to it. It is a control which functions by examining and evaluating the adequacy and effectiveness of other controls; a management tool which analyses the effectiveness of all parts of an organisation's operations and management.'

3.2.5 The Institute of Internal Auditors (IIA) also defines Internal Audit on similar lines as: 'Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.'

3.2.6 These definitions state three clear functions of the Internal Audit activity namely;

a) Internal Control: Internal controls direct, monitor, and measures the company's resources and help to detect and prevent fraud from occurring within an organisation. It can be defined as a process which is performed by the employees of the company as well as the information technology systems that are used to assist the company in achieving its objectives. The management of a company is responsible for establishing the system of internal controls within the organisation, but internal auditors test the controls to make sure they are working effectively.

b) Management Tool: Internal Audit has been used as a management tool which monitors and evaluates the effectiveness of operational processes and risk management of a company. How an organisation sets their objectives and responds to the risks associated with their objective is part of the risk management process. Risk management is a way for companies to manage uncertainty through risk assessment, to develop strategies to manage risk and to mitigate risk by using managerial resources.

c) Internal Check: The term Internal Check is different from Internal Audit. Internal Check implies that the entries passed by one person are automatically checked by another person at the same time. In Internal Check, the system is so devised that the chances of fraud, misappropriation are minimized unless done by collusion.

Thus, Internal Audit as a function must make recommendations to improve the overall internal control environment including financial and legal compliances, to safeguard assets and to improve the operational performance of the organisation as a whole.

3.2.7 Cost Auditing Standard 104 - Knowledge of Business, its Processes and the Business Environment Para 5.3(e)(2) and 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.

CHAPTER –4 COST AUDIT

4.1 Legal Provisions

Companies Act, 2013

On August 30, 2013, the Central Government notified the Companies Act, 2013 (18 of 2013). By virtue of this notification, the Companies Act, 1956 stood repealed.

Section 148 of Companies Act, 2013 enumerates the power of the Central Government to specify audit of items of cost in respect of certain Companies.

Extracts of other Sections of the Companies Act, 2013 that are relevant to understand the scope and application of the provisions of Section 148 & Rules made thereunder are given below.

Section 143 provides for powers and duties of auditors. Provisions contained under sub-sections (12) to (15) are more relevant to the cost accountants in practice conducting cost audit under section 148.

Similarly, section 147 relates to punishment for contraventions by the company and the Cost Auditor of section 148.

Section 469 of the Companies Act, 2013 has empowered the Central Government, by notification, to make rules for carrying out the provisions of the Companies Act, 2013.

Thus, empowered under the provisions of section 469 and section 148 of the Companies Act 2013, the Central Government, acting through the Ministry of Corporate Affairs, notified the Companies (Cost Records and Audit) Rules, 2014 vide notification no. GSR 425(E) dated 30.06.2014. These Rules have been subsequently amended vide notification nos. GSR 01(E) dated 31.12.2014, GSR 486(E) dated 12.06.2015, GSR 695(E) dated 14.07.2016, GSR 1498(E) dated 07.12.2017, GSR 1526(E) dated 20.12.2017, GSR 1157(E) dated 03.12.2018 and GSR 792(E) dated 15.10.2019.

Note: *With the notification of the Companies (Cost Records and Audit) Rules, 2014, all the earlier Rules relating to cost records and cost audit notified in 2011 under the relevant provisions of Companies Act, 1956 stood repealed.*

The above Legal Provisions are not reproduced for the sake of brevity.

4.2 What is Cost Audit

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

An 'audit' is systematic and independent examination of books, accounts, statutory records, documents and vouchers of an organization to ascertain how far the account statements as well as non-financial disclosures present a true and fair view thereof. It also attempts to ensure that the books of accounts and requisite records are properly maintained as required by law. The auditor examines the records produced before him, obtains evidence, evaluates the same and formulates an opinion on the basis of his professional skepticism & judgement which is communicated through his audit report. Auditor provides third party assurance to various stakeholders that the account statements give true & fair view and are free from material misstatements.

The term 'cost audit' means systematic and independent examination of books, accounts, cost records and other documents of an organization to ascertain how far the cost statements present 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) produced or service(s) rendered by the organization. The role, functions, powers, duties and responsibilities of a cost auditor is similar to that of a financial auditor except that the scope of both is different as defined in law.

The provisions relating to Cost Audit are given in section 148 of the Companies Act, 2013.

5.1 Legal Provisions

As per Companies Act, 2013 Section 148(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.

The definition of the word 'cost records' has been provided under rule 2 (e) of the Companies (Cost Records and Audit) Rules, 2014 which means "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 section148 of the Act and the Companies (Cost Records and Audit) Rules, 2014.

Rule 3 of the Companies (Cost Records and Audit) Rules 2014 provides that the class of companies, including foreign companies, engaged in the production of goods or providing services as specified therein and having an overall turnover of Rs.35 crore or more during the immediately preceding financial year, shall include cost records for such products or services in their books of account. The said Rules further provide that

(a) The cost records 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.

(b) 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.

(c) Every company, 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.

A simple reading of the aforesaid provisions clearly tell that the specified class of companies are required to maintain cost records on a continuous basis as an integral part of its books of account. It is also very clear that preparation & presentation of cost records and cost statements is the responsibility of the company management.

But the pertinent question to be addressed here is what is meant by cost records in any company.

Cost Accounting is the process of identification, classification, measurement, and assignment of costs to various cost objects. So to understand what constitutes 'cost records', one needs to first know the following principles:

- Cost records should be maintained for each product or service unit, branch, or office separately;

- Cost records should facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each product and activity separately; and

- Cost records should enable identification, classification, measurement, and assignment of each element of cost separately.

The Companies (Cost Records and Audit) Rules 2014 provide that the company shall maintain cost records in form CRA-1. Form CRA-1 does not contain any formats but prescribe principles that must be followed while maintaining such records. These Rules have no specific mention for maintenance of cost records in accordance with the Generally Accepted Cost Accounting Principles (GACAP) and Cost Accounting Standards (CAS) issued by the Institute of Cost

Accountants of India. However, CRA-1 prescribed in the Rules is in complete synchronization with the Cost Accounting Standards.

Proviso under sub-section 3 of section 148 requires the Cost Auditor to certify that the cost accounting records have been maintained in compliance with the Cost Auditing Standards issued by the Institute of Cost Accountants of India with the approval of the Central Government. As the Cost Auditing Standards requires compliance with the cost accounting standards, hence the cost records must comply with the principles laid down in CRA-1 as well as with the cost accounting standards issued by the Institute. In this context, it may be noted that the Council of the Institute of Cost Accountants of India has already made it obligatory on the part of practicing cost accountants to ensure compliance with the cost accounting standards that are issued by the Institute. Hence, a cost auditor is required to make his observations on any departure from compliance with the cost accounting standards. Such conformance to Cost Accounting Standards is to be followed to the extent these are found to be relevant and applicable and the variations, if any, are required to be indicated and explained.

As already said, there are no formats prescribed under any Rules or Standards for maintenance of cost records. Records pertaining to different cost components and such other details that are required to derive the cost of production, cost of sales and margin maintained according to the prescribed CRA-1 read with the Cost Accounting Standards are the cost accounting records.

The cost statements drawn in the reporting formats, as per prescribed Form CRA-3, are based on the cost accounting records maintained by the company. However these statements themselves, in isolation of cost accounting records, can not be considered to be the cost accounting records.

There cannot be any exhaustive list of cost accounting records. However, an attempt is made to give an indicative list. But the fact is that any statistical, quantitative or other details of any transaction or activity that has a bearing on the cost of the product/activity is relevant and should be included in the cost records. The cost accounting requires three dimensional data viz. quantity, rate & value, compared to the financial accounting that largely require one dimensional data viz. values only. Further, the cost accounting system also requires distinct identification of products/services, product lines, cost centers, etc. Hence, the cost records entail creation of additional set of registers, books, records, etc. However, in an integrated structure, the books of account should be maintained in such manner so as to fulfil the requirements of preparation of cost as well as financial statements and also the compliance requirements for both as prescribed under the relevant statutes.

In case a company is maintaining its books of account under SAP/ERP environment, it is necessary to ensure that it includes a detailed module that can enable element-wise computation of cost for each cost object separately on a regular basis.

Sometimes companies keep the basic information such as monthly labour hours, machine hours and material issues are recorded on a regular basis, besides the financial records required for preparing the quarterly/ half-yearly/ annual financial statements. These base records are not compiled into proper cost accounting records to enable drawing up the cost statements expeditiously. This results in delays at the end of the financial year in preparing the cost statements and annexure to the cost audit report.

The very purpose of the law is defeated if the company opts for maintaining only the very basic cost records and compiling the required statements at the end of the financial year only with the help of such deficient records.

The exorbitant cost of a detailed cost accounting system is often quoted as the deterrent. The situation could be rectified by creating proper cost accounting records at the end of each month/ quarter/ half year and reconciled with the financial accounts / statements, for the internal use by the company in preparation of its routine MIS. In fact it is advisable that cost records and cost statements should be prepared as the basis of internal reporting or MIS, so that the Board is assured of proper and consistent methodology used in their preparation and timely availability to each level of the decision hierarchy. Inconsistencies in application of cost accounting methods or use of inappropriate techniques may result in misleading or meaningless reports. For example, with the product performance being compared against their estimated costs and profitability on a monthly basis, a sudden increase in the cost of a critical resource can be easily spotted and corrected. A financial accounting statement at the end of the month may not give these details.

An internal audit of these interim cost statements could be carried out, in order to ensure a reasonable level of accuracy. The cost of maintaining such a system would be far less than the cost of pertinent decision-making information being unavailable or inaccurate throughout the year.

Preservation of Records -

Regarding preservation of cost records, section 128(5) of the Companies Act, 2013 provides that 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. It further provides 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. Since cost records form an integral part of the books of account as defined under section 2(13) of the Act, preservation of such records are required to comply with the provisions of section 128(5) as above.

CHAPTER –6 DIFFERENCIATION BETWEEN COST ACCOUNTING AND FINANCIAL ACCOUNTING

Both Financial Accounting and Cost Accounting deals with the recording and presentation of financial information, the purpose of the two is different.

1. Financial Accounting records financial data and makes a report their on in the form of Profit & Loss Accounts and Balance Sheet in the given format, the purpose being ascertainment of profitability of the organisation in a given period and ascertaining its financial position on a given date.

   Cost Accounting is the process which records, summaries and reports cost information of an organisation.

2. Financial Accounting records only monetary transactions of the entity.

   Cost Accounting may record both monetary and non-monetary transactions of the entity.

3. The users of financial information are both internal and outside parties.

   The users of cost information are mainly internal management and limited outside parties.

4. Financial Accounting records only historical costs. In Financial Accounting forecasting is not at all possible.

   Cost accounting records both historical and predetermined cost. In Cost Accounting forecasting is possible and is a normal process through budgeting techniques.

5. In Financial accounting income statements are analysed for a particular period for the entity as a whole

   In Cost Accounting the profit is analysed for particular product or service to the smallest unit of accounting like a job or a batch or a process.

6. The purpose of financial accounting is to create record of all financial transaction and to ascertain the financial results for the period of accounting and a state of its affairs in the form of assets and liabilities.

   The purpose of cost accounting is reducing and controlling costs. The focus of cost accounting is to generate data and information so as to keep a control on operations with the objective of achieving the efficiency and their by maximizing the returns.

7. Financial Accounts are more rigid due to legal requirements and can be considered as a positive science.

   Cost Accounting is both a positive and a normative science.

CHAPTER –7 DIFFERENCIATION BETWEEN COST RECORDS AND FINANCIAL RECORDS

Cost and Financial records comprise of account books, registers, documents and vouchers. What constitutes account books? Sub-section 13 of section 2 of the Companies Act, 2013 has defined Books of Account as follows:

"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;

It may be noted that the books/records pertaining to first three activities listed above constitute the accounting records of the company. Though it includes lot of information that is needed for cost accounting but it does not satisfy the full requirements of cost records. Therefore, the law felt it necessary to further prescribe that the books of account shall include records maintained in respect of 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. A simple reading gives a clear understanding that the cost records are distinct from the financial records and both put together constitute the 'books of account'.

Cost data/information is disaggregated and cost statements are prepared in respect of each unit, for each product or service and for each pack separately. Whereas financial data is available in an aggregated form and the financial statements are prepared for the company as a whole. Hence, the cost records are required to be prepared for each unit, branch, and cost center. Further, these must contain quantitative, rate and value information in respect of each product or service separately. Therefore, cost records will require more minute details and information by maintaining additional set of registers, books, records etc. for the various cost objects.

Features or characteristics that make cost records different from "financial" records:

1. CRA-1 describes the items that constitute cost records and the manner in which they may be maintained.
2. The preparation of CRA-3, Annexure to the Cost Audit Report, may be "monthly or quarterly or half yearly or annually.
3. It is to be maintained continuously for every financial year from the year for which it becomes mandatory.
4. The purpose of maintenance of cost records is explicit – to enable the company to exercise control over operations and efficient utilisation of resources.

The major areas of difference between Financial and Cost Records may be stated as under:

1. The cost records may be more detailed and specific, as compared to financial records, in terms of product, job, batch, activity or service in respect of which the record is being prepared.
2. The cost records may involve recording activities that do not impact financial records. For example, transfer of material from one job or batch to another job or batch of the same product may not require a financial accounting entry, but a cost accounting record would be necessary for ensuring reasonable accuracy at the job or batch cost sheet level in the cost records.
3. Certain estimates of cost may require a different treatment in cost records. For example, Royalty for technical knowhow payable on sales may not be accrued on manufacture in financial accounts, but accrued in cost accounting records of that product.
4. Certain expenses may not be recorded in the cost records for the products or services for which the cost records are being prepared, but treated as an entry in the costing profit and loss account. For example, a marketing campaign for improving the image of the corporate entity may not be apportioned to the products or services sold during the year in the cost records, but shown in the Costing P&L A/c.
5. The objective of the cost records is to enable decision-making and control, and hence may be presented in ways other than that required/mandated for financial accounting records. The use of visual tools such as charts, graphs and diagrams is common in the case of cost records for internal use. The statutory requirements regarding presentation are given in form CRA-3, which is mainly for presentation to the Authorities.

6. Cost records usually differentiate between the controllable and non-controllable expenses and incomes, normal and abnormal costs and revenues, behaviour of the costs in response to the level of activity etc. at the incidence or estimation of cost and treat each differently.

As per the Companies (Cost Records and Audit) Rules, 2014 5(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.
5(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.

CHAPTER –8 INTERNAL AUDITOR OF COST RECORDS AND EXTERNAL (STATUTORY) AUDITOR OF COST RECORDS

INTRODUCTION

Both Financial Audit and Cost Audit are the statutory audits under the provisions of the Companies Act, 2013. The law makes it mandatory to have the internal audit to certain companies under section 138 of the Companies Act, 2013. A corollary follows that the internal audit of Cost records is also mandatorily prescribed under the provisions of the Companies Act, 2013. Due to legal provisions and its acceptance by the companies the statutory audit and the internal audit of financial records is carried out separately by the two sets of auditors i.e. the auditor appointed by the shareholders under section 139 of the Companies act and the Internal Auditor appointed by the management of the company. Defining the scope or areas for the internal audit is specifically assigned to the audit committee (The Companies (Accounts) Rules, 2014 Rule 13). Similarly it is necessary for the audit committee to put in practice a system of internal audit of cost records. The responsibility may be assigned either to an outside agency (A firm of Practicing Cost Accountants) or internal team.

Familiarity with different industries makes a cost auditor capable of passing on a share of his knowledge to the development of an internal (cost) audit system and that of an 'internal check' system particularly with respect to cost accounting system and records, including the checks inherent in inter-linking and inter-locking the various cost performance prescribed under the relevant Cost Accounting Records Rules.

The internal auditor, if additionally entrusted with the task of internal cost audit as a part of his operational audit assignment, can enlarge the scope and enrich the performance of his audit function.

Internal Auditor's Assistance:

In carrying out his duties and discharging his audit responsibilities, the Cost Auditor may also derive much assistance from the Internal Auditor's intimate knowledge of the accounting system and technical knowledge of the business, particularly in connection with the various processes of manufacture, key points of controls, stocks-in-process, physical existence of fixed assets, depreciation charges, inter-connection between various operational activities, the ascertainment of liabilities, the adequacy and effectiveness of financial as well as non- financial controls and the risks and chances of fraud or misappropriation, and also intercompany transactions.

Mutual Assistance:

Where an organisation has an internal audit department, the management usually delegates to it some of its supervisory functions. This particular function constitutes a separate component having been undertaken 'by specially assigned staff with the objective of determining whether other internal controls are well-designed and properly operated'.

While the statutory cost auditor has sole responsibility for 'his report and for the determination of the nature, timing and extent of auditing procedures', much of the work of internal audit in this direction (i.e. related controls) may be useful to him in his examination of the cost and financial information.

Where the statutory cost auditor can conclude that the internal auditor has adequately covered part of the work which the cost auditor would do otherwise, he may be able to reduce the extent of his examination of details keeping in view the 'time- constraints' of his cost audit work.

Having decided in principle to use the work of the internal auditor, the cost auditor can ascertain the internal auditor's tentative plan for the year and discuss with him about possible areas 'where he believes he could use the internal auditor's work'.

They should agree in advance on the aspects like—audit time-table, audit coverage, compliance tests, methods of sample selection, documentation of the audit work done, and procedures of review and reporting.

Examples of specific ways in which the work of the two auditors may be coordinated are:

(i) Whether the system of internal check is operating satisfactorily and in assessing the general reliability of the cost accounting records,

(ii) The programme on matters, such as cash verification, visits to branches and associated manufacturing units, verification of fixed assets, either by the internal auditor alone or jointly with the cost auditor, and

(iii) The programme at the end of the accounting period on matters, such as the verification of closing stocks, closing work-in-progress, closing capital jobs-in- progress, the confirmation of stocks lying with go- downs elsewhere, and the preparation of audit working schedules required by the cost auditor as his evidential records.

Thus, timing of liaison and co- ordination between the two auditors would ensure more credibility to the facts presented in the cost accounts of the company although obligations are entirely different.

Important points relating to the two auditors may be noted as under

(i) Internal Cost Auditor has no legal obligations either to the Government or to the cost auditor, and

(ii) Internal Cost Auditor has no criminal liability other than the contractual liability arising from the service agreement or terms of reference (in case of audit firms hired for the purpose) entered into between him (or hired Audit Firm) and the management. As against the background the cost auditor's appointment his duties and responsibilities and liabilities stand on a different footing.

(iii) The expectations from an external cost auditor are from statutory perspective. The requirements expected from an internal cost auditor are for management interest.

(iv) An external Cost Auditor has to face severe penalties for the following acts and omissions.

(a) Certifying a report without examination being made;

(b) Failure to disclose in a cost or pricing statement, a material fact known, which it is necessary to disclose so as not to make the statement misleading;

(c) Failure to report a known material misstatement appearing in a cost or pricing statement;

(d) Gross negligence in professional duties;

(e) Failure to obtain sufficient information to warrant expression of an opinion; and

(f)Failure to invite attention to any material departure from the generally accepted procedure of cost accounting and policy applicable to the circumstances, on the part of a statutory cost auditor constitute professional misconduct according to the Cost and Works Accountants Act.

(g) he is subject to criminal liability under sec. 197 of the Indian Penal Code for issuing or signing any certificate required by law, knowing or believing that such certificate is false in any material point, and held responsible for the damage caused to his clients arising from negligence and liable to guilty of misfeasance if the company suffers any loss due to his wrongful performance of duty.

(v) Under the above situations, the liability of a statutory cost auditor is far greater than the internal auditor.

(vi) The objective of having a separate internal cost auditor is to assist the external Cost Auditor or Financial Auditor with a view to tiding over the problems associated with such audit disciplines.

(vii) It is up to the external Cost Auditor's personal choice and judgment to depend or not to depend, to rely or not to rely, on the work of the internal auditor. The binding between the external cost auditor and internal auditor on some aspects of audit is neither legal nor a compulsion but a matter of convenience based on mutual relationship and co-ordination.

"The internal auditor's responsibility is to the management and he is in no sense a servant of the independent auditor. It follows, therefore, that the extent to which the internal auditor can so arrange his work as to be of specific assistance to the independent auditor will depend upon— the decision of the management, the scope of internal audit and the number of staff employed thereon. Consultation between the two auditors, and where necessary with the management, should however ensure that so far as is practicable the fullest possible assistance is available to the independent auditor"—(Institute of Chartered Accountants, Eng. and Wales).

In this regard, the following recommendations contained in the international auditing guideline issued by the International Federation of Accountants are very relevant—

"The report of the external auditor is his sole responsibility and his responsibility is not reduced by any use he makes of the internal auditor's work. Thus, judgments relating to the audit of the financial information must be those of the external auditor."

"The external auditor should also test the work of the internal auditor which he intends to use. The nature, timing and extent of his tests will depend upon the external auditor's judgment as to the materiality of the area concerned to the financial statements taken as a whole and the results of his evaluation of the internal audit function and of the specific internal audit work. His tests may include examination of items already examined by the internal auditor, examination of other similar items and observation of the internal auditor's procedures."

The ultimate responsibility of the Statutory Cost Auditor for expressing his opinion about the proper maintenance of cost accounting records by the company "so as to give a true and fair view of the cost of production, processing, manufacturing activities and marketing of the product under reference" is bestowed upon him. Accordingly, he cannot take shelter under the plea that he relied on the internal auditor and the internal control system.

The difference between internal and external auditor of cost records

Some characteristics of internal and external audit can be explained in the table below:

Reporting : External Cost Auditor submits his report to the Board of Directors of the company and in turn, company has to furnish such report to the Central Government alongwith full information and explanation on every reservation or qualification contained in the report.

Internal cost auditor submits his report to the top management, preferably the audit committee of the company.

Objectives – External cost auditor gives credibility and reliability to cost information on annualized basis being submitted to the Board and to the government by expressing his opinion in his report.

Internal cost auditor evaluates and improves the effectiveness of governance, risk management and control processes. This provides members of the boards and senior management with assurance that helps them fulfil their duties to the organisation and its stakeholders.

Coverage – External Cost auditor reports on a true and fair view of cost of production of products, services, cost of sales , margin, maintenance of cost records, adherence to cost auditing standards etc.

Internal cost auditor reports on internal control systems, performance and efficiency in operations etc.

Responsibility for improvement - External cost auditor has to submit his observations and suggestions relevant to the cost audit in his cost audit report. Though not statutorily mandated, as a good practice the external cost auditor is supposed to give areas for improvements to the auditee. The company management has to consider the observations and suggestions of the external cost auditor and to implement the suggestions, for improving the performance. The duty of the external cost auditor ends when he submits his report to the Board.

Internal cost auditor, is more closely associated with the company and he has to provide his observations and suggestions on shorter periods and it may be considered as his primary responsibility. Internal cost auditor has to get himself involved in actual implementation of his suggestions and should continuously follow up for the execution and review thereof.

CHAPTER –9 VALUE ADDITION TO THE MANAGEMENT OF THE COMPANY

Cost management is one of the most critical areas in any organization. In this era of global competitiveness and stressed economy wherein all businesses are witnessing very high rate of disruptions, it is very necessary for the Board and top management to achieve 'cost advantage' by deploying the most advanced cost innovation techniques. This entails using innovative business models that provides value to the customers at most competitive cost. There is need to understand the importance of ecosystem that comes from the consumer side not from the producer side. Manufacturing sector competitiveness, which is being pulled down by 'extraneous' factors such as high cost of land, electricity, taxes, etc, require disruptive cost management skills to stay afloat. Managing 'costs' can become a game changer and provide sustainability against the market swings. Thus, cost management remains as one of the most critical areas in any organization.

How to achieve this? Among various other teams in the organization, one of the important contributors could be the internal audit function. The skill-set and experience of the internal cost audit team can study the most critical areas requiring cost improvement, including the changes required in the materials, processes, etc. and undertake detailed data analytics and give number of innovative suggestions to the company for addressing the cost management issues. Internal audit of cost records can throw light on the changes needed in business strategies & plans. Internal cost auditor's business performance reporting to the Board/Audit Committee would tell which unit, product, service, or function necessitates margin improvement through revolutionized cost structure, cost corrections and cost transformations.

One of the successful ways to achieve the target results from the internal audit could be if the internal cost auditor undertakes the performance appraisal exercise and give quarterly report to the management. The purpose of performance analysis is to determine if a company is performing well and to identify areas, activities, processes, products, services, etc. that requires improvement. The implications of formulating strategies include many parameters where the cost impact is significant one and hence the cost auditors' appraisal of the performance of the company is an important input for the top management of the company. The report provides a professional expert review perspective. It serves a very useful purpose by drawing management's attention towards key issues and helps overall improvement in the performance of the company.

The internal cost auditor can provide a Performance Appraisal Report for an actionable insight into costs, efficiency, productivity, profitability and sustainability of various products/segments of the company for enabling the management to assess the performance in the strategic and operational context. The aim would be to discover various drivers of costs and profitability and their impact on the performance variables with the objective of helping the organizations to improve profits and profitability; to optimize resource allocation and utilization thereof; to optimize the product and services portfolio; to monitor performance of the company in various areas; and to know if company management is meeting its goals.

Internal Cost Auditor evaluates the cost accounting system followed by the company and its efficacy on reporting the resource utilisation and efficiency parameters. The internal cost reporting also follows the business process flow within the organisation. Hence, the management would like to have a report which is presented production/service unit-wise, SKU/SBU wise, business vertical-wise, domestic/export customer group-wise, process-wise and product/service/activity-wise analysis and not for the company as a whole. Therefore, the periodicity of performance appraisal report should be quarterly so as to enable the management constantly guard the progress and facilitate better analysis. In this way, it would give a real-time data/analysis to the Audit Committee/Board to take effective business decisions.

An internal audit of the cost records will assure the Management that the cost information, which is basis of their evaluation of performance, risk management and control, is reliable and timely.

Utility of Segmental Reporting as per Financial Statement as compared to Cost Statement

A simple reading of the segment reporting of the listed companies on BSE reveals that most of the companies give minimal level of information, as mandated by the law. The information is so generic that it cannot generally be used for industry analysis or comparison of peers by any of the stakeholders, including the Government.

As against this, the form CRA-3 summarises the cost statements of the company under cost audit, into products or services on the basis of CTA or Service Accounting Codes. This renders the data from different companies comparable at various levels – capacity utilisation, cost of production or operations, average revenue and profitability etc. This is available to the Government as a summary, and to the Board of Directors in detail, containing statements of profitability analysis at geographical segments, customer, product/service groups etc. that are compiled from the cost records, comparing the changes over at least the previous period.

An internal audit of the cost records will be useful in assuring the Board that the results or analysis as reported to them tie-up with the financial statements for accuracy and yet give the information needed at the time of decision making.

The Board of Directors is required to approve the Annexure to the Cost Audit Report and the Cost Statements before presenting them to the Cost Auditor. The internal audit of cost records will help the Board in determining the level of accuracy of these statements, and their conformity to the Cost Accounting Policy laid down by them, and also evaluate compliances. The areas of Internal Audit of Cost Records should cover all aspects of cost records preparation, presentation and disclosures, from the perspective of timeliness, reliability and completeness of information. The assurance of a reasonable level of accuracy in the cost statements and reports (both statutory and internal) is required, as defined by the Cost Accounting policy of the entity. Where no defined Cost Accounting Policy exists, Internal Audit of Cost Records should also evaluate conformance with the Industry norms and GACAP.

Value Addition To The External Cost Auditor

The Cost Auditor needs to comment on the efficacy of the internal controls in preparation of the cost statements and Annexure to the Cost Audit Report. An internal audit of the cost records on which these statements are based, will give the Cost Auditor an independent view on the internal controls involved.

CHAPTER –10 SPECIFIC EXPERTISE REQUIRED FOR INTERNAL AUDIT OF COST RECORDS

Why Internal Audit of Cost Records require specific expertise?

After observing the internal audit functions of certain corporate entities (multinational, Indian family managed and Indian professionally managed), the following broad objectives and areas of internal audit could be discerned:

Objectives –

a. Testing the internal controls for conformity with the laid down policies and procedures, exception handling, change management in those areas of operations that are defined in the Internal Audit charter.

b. Compliance with the laws in force

c. A reasonable assurance that the financial records that are used in generating the financial statements and MIS are factual and accurate

Areas –

a. Procure to Pay

b. Order to Cash

c. Inventory

d. Fixed Assets

e. Investments and Borrowings

Limitations of the traditional or legacy internal audits in meeting the requirements of Internal Audit of Cost Records:

1. The concept of Materiality –

Materiality of transactions plays an important role in selecting the areas for audit and defining the depth of the audit tests. Therefore, in most of the cases, we find that the areas are traditionally defined in such manner that the quantitative and statistical records are not covered in great depth. Stress is laid on the financial impact of the transaction. When considered at the individual transaction level, the impact may be small and may not meet the test of materiality, from the perspective of the financial records. Therefore, the depth of testing and the level of importance attached to deviations observed would be low. These may however be important from the cost accounting records perspective, as certain operations may be consumed by one product, while others may not. The evaluation of efficient planning and utilisation of the corresponding assets and resources cannot be reasonably accurate without this detail, however immaterial it may appear at the enterprise profitability level.

2. Financial Accounting Impact –

In the majority of the cases, it is observed that the transactions that have little impact on the financial accounts are not recorded in great detail. These are either ignored or summarised. An example of this could be purchase of consumable stores, packing material, housekeeping and facilities management expenses. While the financial records of receipt of material and services and corresponding payables may be found in the books of account, there is no assurance of the availability of details of utilisation of these by individual products or services or even production areas or sites. In these cases, the profitability of individual products or services may be impacted if the utilisation is not recorded with reasonable accuracy.

3. Cost of utilising fixed assets, technical knowhow and capacity costs –

Most companies follow a single set of base records for preparing the cost records and financial accounting records. This necessitates the maintenance of accounts as per the Companies Act, 2013. While most companies ensure that this is in line with the financial accounting requirements, at the level of Cost Accounting Records as per CRA-1, there may be a need to recompute certain amounts for the cost statements, with balances of expenses flowing into the reconciliation statement.

4. Purely financial transactions – Just as the financial statements may be prepared from financial accounts, ignoring some transactions that do not have a monetary impact, there may be some purely financial accounting transactions that are not to be considered in the preparation of cost accounting statements. Accountants, and consequently internal auditors, would traditionally not bifurcate the financial transactions into those impacting cost statements and others.

From the above limitations of the legacy internal audit system, we can see that an internal audit of the cost records will require:

1. A deep understanding of the operations, business processes, business environment and information systems of the entity, in order to be able to identify cost flows, alongside the monetary and material flows of the entity.
2. A very thorough knowledge of the requirements of the Cost Accounting Records & Audit Rules
3. Proficiency in the knowledge and application of cost accounting methods and techniques, Cost Accounting Standards, industry specific norms and the Generally Accepted Cost Accounting Principles.

Considering these requirements, it is suggested that a seasoned Cost Accountant with experience in the areas of expertise mentioned above is the best fit.

CHAPTER –11 INTERNAL AUDIT OF COST RECORDS

11.1 Legal Provision –

The Companies Act, 2013, Section 148 provides for statutory cost audit.

Section 469 of the Companies Act, 2013 has empowered the Central Government, by notification, to make rules for carrying out the provisions of the Companies Act, 2013.

The Ministry of Corporate Affairs, Government of India has notified The Companies (Cost Records and Audit) Rules, 2014. Form CRA-3 prescribes Form of the Cost Audit Report.

The certificate from the cost Auditor includes clause (v) which reads as under

"(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."

Thus the Companies Act mandates adequate system of internal audit of cost records. The statutory cost auditor is required to certify the adequacy of the system of internal audit of cost records. While certifying, he has to get himself convinced about internal audit of cost records. Many times, it is posed and projected that the existing system of internal audit itself meets the requirements of internal audit of cost records. Though the books of account is a common database, the internal audit of financial records and the internal audit of cost records are two separate & distinct disciplines. The knowledge and expertise required to carry out these two internal audits are totally different. The scope and the areas, the records to be audited, the focus of the audit, the objectives of the audit are different. The Companies Act, 2013 itself provide for two separate audits - 1. Financial Audit & 2. Cost Audit. The authorities carrying out these audits are also different and mutually exclusive.

It may be noted that, Form of Cost Audit Report specifically provides for "Observations and Suggestions, if any" of the cost auditor relevant to the cost audit. This speaks about volume of differentiation between the two audits. The rights, duties, obligations of the two auditors may be same but the objectives widely differ. There is no role or question of providing "observations and Suggestions" by the financial auditor whereas it is one of the primary role and function of the cost auditor to provide his observations and suggestions relevant to his cost audit.

A corollary follows that the company looks upon the internal cost audit system as a proactive audit which is basically to provide inputs to the management for achieving better efficiency and performance. Internal cost audit is more oriented towards the internal management of the company. Rather than focusing on compliance audit, it focuses on operational efficiencies for betterment of the organisation.

Internal audit of cost records is a specialized service and the cost benefit analysis is always in its favour. However, it is noted that little significance is given to this function and the companies do not get the benefits of cost audit, they deserve. Many times, some limited areas of internal audit of cost records are assigned to existing team of internal audit and it is considered as a compliance of the requirement of internal audit of cost records. Such an approach may be in the nature of self goal and should be avoided. An effective and robust system of internal audit of cost records, should get developed for the benefit of Indian industry and Indian economy.

11.2 Objectives

The following are the primary objectives of conducting an internal audit of cost records in an organisation.

1. Exercising Control:
Internal auditing activity is primarily directed at evaluating internal control. Internal audit of cost records facilitates control over various business operations and activities. The control would further ensure efficient operations leading to cost advantage. The extent of internal control can be outlined. Internal controls are absolutely essential in any business organisation which is essentially a responsibility of Board of Directors and the Management of the company.

2. Cost Accounting System:
It would evaluate the cost accounting system of the organisation. Internal cost audit ensures implementation of the cost accounting system meeting requirements of various cost accounting standards and Generally Accepted Cost Accounting Principles. The cost bookings to the cost objects or cost centres or departments are checked in the process which leads to accuracy and reliability of cost ascertainment.

3. Cost Accounting Policies: The entire costing structure is based on the cost accounting policy adopted by the company management. Adherence to the policy at different levels of operations is necessary which can be ensured in the process of internal audit of cost records. The policies once decided by the top management need to be reviewed also periodically and these policy revisions necessited by the changes in business environment can be suggested by internal cost auditor.

4. Achieving accuracy in maintenance of records and periodic cost statements: Internal audit of cost records ensures proper cost bookings, allocations, apportionments and cost absorption on scientific basis. In practical accounting, various challenges are encountered which leads to wrong results. If the costs are not booked properly to the respective cost centres, the resultant cost statements will be far from the real or actual cost. Hence, the internal checks are essential for correct recording of costs, which is possible only through internal audit of cost records.

5. Continuous Review:
Internal audit of cost records, is a continuous process going side by side the business operations. This continuous review and comparisons over period gives significant inputs to the management by highliting the areas which need the attention most.

6 Asset Utilisation:
Internal audit of cost records will continuously monitor the utilisation of various assets and resources at the disposal of the management. The success of any business largely depends upon the maximum utilisation of its resources. A continuous study and analysis of available capacities and actual utilized capacities brings to surface the opportunities lost by the business. It is one of the most prime concern area for any management and the information to the minutest level always leads to actions for improvement in the utilisation of resources. Various studies relating to capacity can be undertaken in the process of internal audit of cost records which will immensely benefit the management for decision making.

7. Assist external Cost Auditor: An internal audit can help an independent audit. The external auditor has the option to rely on an internal auditor instead of conducting another cent percent check, saving both money and time.

The statutory Cost Auditor has lesser time to complete the audit since the timelines are to be observed for submission of cost audit report. The objective of statutory cost audit and internal cost audit are also different. If there is strong system of internal audit of cost records, the statutory cost auditor can place reliance on the areas covered by the internal cost auditor. In large scale organisations, it may not be possible for statutory cost auditor to go into intricacies of the cost records and carry out an in-depth verification. The job of statutory cost auditor will be greatly facilitated if there is robust system of internal audit of cost records.

Paras 1 to 17 of CRA-1 cover detailed explanation on various cost elements/ items of expenditures. Paras 18 to 31 deal with various other relevant costing matters such as – inventory records, production records, statistical records, cost statements. Internal audit of cost records should encompass, all the details covered in above paras.

It is for the statutory cost auditor to satisfy himself that internal audit function (carried out by company's in-house department or external independent professional) thus covers all paras in CRA-1.

Statutory cost auditor should peruse the reports generated by internal audit functionaries and obtain a suitable certificate for due coverage in 'scope' as well actual exercise.

Further, he should get management letter regarding status of suggestions and corrective actions specified in internal audit of cost records.

8. Assistance and guidance to Management:

Internal audit of cost records is a valuable tool in the hands of management which can carry out SWOT analysis in most effective manner. It can point out the lacunas or weaknesses in the organisation and also suggest ways to overcome.

9. Performance Appraisal:

Internal cost auditor is the best and most suited professional for performance appraisal of the organisation. He is observing the performance of various levels of management right from supervisor during the process of his audit. The norms can be set by the management and actual achievements can be compared against the norms to evaluate the performance. This is one of the primary function of the internal cost auditor and possibly no other professional will have such deeper knowledge of the organisation and its functioning than that of the internal cost auditor. Performance appraisal can only lead to performance improvement. The performance not only of the employees but of various factors of production can also be best evaluated by internal cost auditor. E.g. performance of assets employed, various other resources employed, capital employed etc.

10.Valuable suggestions:

The internal cost auditor is not only carrying out the function of checking and verification and reporting the errors etc. but he has a greater role in providing constructive suggestions to the management. The suggestions which can be given have no restrictions or boundary. Suggestions can be given both for corrective actions as well as for improvement in the performance and efficiency of an organisation. The internal cost auditor can even come out with new and innovative suggestions benefiting the organisation.

11. Risk Management

Over the years, Risk management has assumed greater role and importance in business operations. Risk management is the process by which an organization identifies, analyzes, responds, gathers information about, and monitors strategic risks that could actually or potentially impact the organization's ability to achieve its mission and objectives. The internal cost auditor is best equipped in the function of Risk Management. During the conduct of his audit, he has an opportunity to come across various business risks both within and outside the business. Internal cost audit is associated not only with financial data but also with nonfinancial and qualitative data both within and outside the organisation. He will be a great aid to the management in risk management.

12. Detect Malpractices and Frauds:

Internal audit of cost records, establishes various relationships like input out ratio, standard vs. actual and resultant variances which throw the areas of concern. Many times the same issues may be on account of malpractices and frauds taking place in the organisation. No doubt detection of malpractices and frauds which are done intelligently is a difficult task but the experienced internal cost auditors can detect the same with their professional expertise and wider exposure.

13. Corporate Governance –

Corporate Governance is the buzzword of todays' business operations. With the changes in time, the focus is shifted more to ethical standards and governance framework for corporates. Corporates work in and for society and as such even corporate social responsibility is on the statute books. The board of directors is responsible for creating the framework for corporate governance that best aligns business conduct with objectives. Specific processes that can be outlined in corporate governance include action plans, performance measurement, disclosure practices, executive compensation decisions, dividend policies, procedures for reconciling conflicts of interest and explicit or implicit contracts between the company and stakeholders. The internal cost auditor can assume a greater role in corporate governance. The various issues to be covered under corporate governance framework can be evaluated and the top management can be appraised thereon by the internal cost auditor.

14. Special Assignments:

The internal cost auditor is fully familiar with the organisational functioning and operations. Any special assignments can be most effectively handled by internal auditor of cost records.

11.3 Areas and Scope

The areas of Internal Audit of Cost Records should cover all aspects of cost records preparation, presentation and disclosures, from the perspective of timeliness, reliability and completeness of information. The assurance of a reasonable level of accuracy in the cost statements and reports (both statutory and internal) is required, as defined by the Cost Accounting policy of the entity. Where no defined Cost Accounting Policy exists, Internal Audit of Cost Records should also evaluate conformance with the Industry norms and GACAP.

The scope of internal audit of cost records has no structured format nor it has boundaries. The scope is to be defined by the top management of the company. Depending upon the requirements of the management and strengths and weaknesses of the organisation, the scope will vary. The basic scope in nutshell can be to check, evaluate, analyse and suggest the cost related records. This will include the cost accounting system, the cost accounting policy, adherence to cost accounting standards, adherence to cost auditing standards, adherence to GACAP. However, the quantitative records may be considered as the heart of cost auditing. The scope will certainly include quantitative data verification of various cost elements, physical parameters, resources employed and so on. In addition to normal features of any internal auditing system, the efficient and performance evaluation of the various operations of the organisation will be the major scope for internal cost auditor. It may be pertinent to note that, the internal cost auditor has to act as eyes and ears of the management and the expeditious reporting is equally important requisite. Finally, the scope of internal cost audit will certainly include the suggestions for the management.

11.4 Audit Standards

The fundamentals of audit have been well documented in various auditing standards. Similarly, the principles of cost audit have been documented in the Standards on Cost Auditing issued by the Institute of Cost Accountants of India. The Institute has also issued a Practical Guide to Standards on Cost Auditing. These Standards & Practical Guide provide guidance to the cost auditor through each step of the audit process with regard to the audit procedures to be followed; responsibilities of the cost auditor; and cost reporting. Members should carefully go through these Standards and make best use of them.

11.5 Framework of Internal Audit of Cost Records

It may be seen that the cost records are different from the financial records; though some books and records are common to both. Therefore, internal audit of cost records would entail not only the audit of common books of account and records, but also the specific books and records that comprise cost records. The constitution of cost records as per the statutory requirement of Form CRA-1 of CCRAR,2014 are given in chapter no. 14.

11.6 Engagement of an Internal Auditor

Before engaging an internal auditor and to bring clarity in the engagement, the organization should comply with certain pre-conditions. It should have its own well-defined Internal Audit Policy that should be duly publicized and disseminated. Top management should address all internal stakeholders clearly detailing the importance and independence of internal audit function.

After deciding whether the internal audit function should be in-house or outsourced, there is need to decide competence, experience and composition of the internal audit team. Similarly, the responsibilities of the management and of internal auditor should be well defined.

11.7 Audit Strategy and Planning

After accepting the engagement, the first step is to formulate audit strategy and audit plan. The audit strategy describes the audit objectives, scope, broad milestones, priorities and performance assessment of the internal audit team members. Audit plan details the areas to be covered, methodology, procedures, allocation of work for each team member, timeline chart, reporting timeline etc. and the support required from other professionals.

In case of internal audit of cost records, the audit strategy and audit plan may cover the unit(s) selected, the products or services to be covered, the critical cost areas to be examined, and the processes that require detailed study from the point of cost management.

Audit Project Selection or "Annual Audit Plan" -

Based on the risk assessment of the organization, internal auditors, management and oversight boards determine where to focus internal auditing efforts. This focus or prioritization is part of the annual/ multi-year Annual Audit Plan. The Audit Plan is typically proposed by the CAE (sometimes with several options or alternatives) for the review and approval of the Audit Committee or the Board of Directors. Internal Auditing activity is generally conducted as one or more discrete assignments.

11.8 Audit Methods and Documentation

The methodology of internal audit would largely remain same irrespective of its scope viz. internal audit of financial records or internal audit of cost records. It still remains same even when the internal audit covers other areas viz. risk management, operations, policies, frauds, IT audit, social audit, quality controls, etc. However, what differs is the nature of data/information, and books & records. At the same, depending upon the area of audit, the internal audit team would be required to change its application skills and data analytics. It may also require support of professionals/experts from other disciplines.

Audit methods involve sampling, testing and data analytics. In the sampling, the auditor decides the target population, sampling size, sampling technique, etc. In the testing, the auditor is required to perform compliance tests, application controls and soft controls. The auditor also performs the analytical & IT techniques.

Documentation includes compilation of all essential working papers, from the stage of audit planning to the finalization of results. The internal audit documentation should be comprehensive, complete, relevant, simple & logically arranged.

11.9 Risk-based Internal Audit

The internal audit provides an assurance to the management on the adequacy and effectiveness of its systems, processes, and controls. This requires review of the enterprise risk management (ERM) system and adequacy & effectiveness of internal controls. The ERM should cover the strategic, operational, financial, compliance, reporting and reputational risks. Various provisions in the Companies Act 2013 and SEBI regulations require a company to have proper risk assessment & management policy & systems. Board in its report is required to include a statement indicating development and implementation of a risk management policy. Audit Committee is responsible to evaluate the internal financial controls and risk management system. Besides, the independent directors are also assigned this role. All these depend upon the assurance provided by the system of internal audit.

11.10 Report Writing

The internal auditor submits his audit findings and suggestions to the management and/or Audit Committee vide Internal Audit Report. The auditor should first discuss his findings & observations with the concerned officers of the company before finalizing his report. While drafting the report, the auditor should be clear about the subject. The audit observations/findings should be correct, fulfill the requirement of the reader, easy to understand, consistent and supported with credible audit evidence. The report should be duly structured covering the subject of audit, information collected, observations/findings, impact on the business, suggestions/recommendations and request for response/comments/action. The audit report should also give details of the audit procedures and methodology used, basis of findings, risk attached, and suggested corrective action or recommendations.

11.11 Periodicity of the Internal Audit of Cost Records

Companies (Cost Records and Audit) Rules 2014 provides that

(a) The cost records shall be maintained on regular basis;

(b) The cost records should be maintained for units and branches; and

(c) It should 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.

Thus, the requirement under law is that the records should enable preparation of cost statements for all its products & services on monthly or quarterly or half-yearly or annual basis. However, the audit requirements of reporting to Government are annual wherein the cost auditor is required to certify whether the company has adequate system of internal audit of cost records which is commensurate to its nature and size of its business.

As far the framework of internal audit is concerned, the internal auditor generally submits monthly report to the management and quarterly report to the Audit Committee/Board. Same framework needs to be adopted with respect the internal audit of cost records. Alternatively, the unit, department or product specific internal audit report should be submitted to the management on monthly basis that requires immediate corrective action in order to improve production, productivity, efficiency and costs. And the report covering critical operational areas, future strategy, risk management, internal cost control systems, etc. should be submitted quarterly to the Audit Committee/Board. This will draw level-attention and help the company to address all issues in perpetuity.

The Internal Audit runs could be conducted by functions or by processes. The periodicity could also vary as per the criticality of the records.

CHAPTER –12 APPROACH OF INTERNAL AUDIT

Approach & methodology to Internal Audit of Cost Records should be akin to that of the Internal Audit of all Operations and Financial Records. The approach may be enunciated in terms of a broad outline rather than specific direction, as it would vary as per the nature of business, size of the entity, risk exposure, organisation structure, level of manual intervention required in the preparation of cost records, and so on. It is suggested that the cost records be classed into functions such as operational/manufacturing, sales, distribution, storage/warehousing, planning, procurement, recruitment and so on. Next, the preparation process is classed into activities such as data gathering, validation, compilation, analysis, reporting and feedback. The required flow of information and corresponding internal control structure should be mapped and documented, the statements (such as rules of allocation, assignment etc.) should be defined. The report structures, distribution lists, levels of aggregation or analysis and feedback mechanism should be documented, based on the Cost Accounting Policy. The reports and reporting levels need to be further classed by their importance or impact on the business into critical, moderate or low importance records. The parameters for evaluation of controls should be defined in terms levels of accuracy required for critical control, moderate and low control areas. This will require a risk analysis, that is, the identification of risks and their impact in terms of money as well as intangibles. Once this map is ready, the actual information flow and internal checks and controls should be observed and evaluated against the set parameters. The methodology adopted for each kind of record will depend on the nature and level of risk involved. For example, in an ERP environment that has a fully integrated cost accounting system, checking hash totals may be superfluous. However, if the cost records are prepared outside the system, such simple checks would be required to mitigate the risk of human error.

CHAPTER –13 SYSTEMS AUDIT AND INTERNAL AUDIT OF COST RECORDS

Systems Audit and Internal Audit of Cost Records:

There is a very close relationship between the cost records and the Information Systems of the company. The basic record of every transaction of a company is maintained by the company in various forms – manual records (such as security gate register), electronic records (CRM, SCM), Policy Statements and Organisation Charts, Authorisation Matrix, and so on.

An internal auditor would normally study the information system in search of any evidence of lapse of control. A detailed system audit is, however, not expected from the internal auditor. An expert in Information Systems would normally be called for.

It should be noted that such an expert would be of use in ascertaining that level of accuracy, completeness and adherence to change management policies has been maintained in so far as the output of the system is concerned. Such an expert, however, would not be equipped with the detailed knowledge of the industry norms, business environment, business processes and accepted practices and how to alter the system when any norm or premise needs to be changed. For example, a change in the GST rates is announced by the Government. Accordingly, the Tax or Accounts department of the company informs the IT department to make the changes. The Systems Auditor may check if the proper authorisations and approvals were in place to make the change. He will, however, not be in a position to see whether the business projections for the next month that are churned out by a different set of data with the Finance/Accounts Department were properly adjusted for this change. In this case, regular maintenance of cost records would lead to preparation of the actual and projected Indirect Tax reconciliation statement for the period, and be audited by the Internal Cost Auditor.

Hence, we can see that regular systems audit needs to be supplemented by an internal audit of cost records, for better control and risk management.

CHAPTER –14 CONSTITUTION OF COST RECORDS (STATUTORY REQUIREMENTS OF FORM CRA – 1)

The Companies (Cost Records & Audit) Rules, 2014 - Form CRA-1 prescribes particulars relating to the items of costs to be included in the books of account. CRA-1 includes the various elements of costs and revenue, the statistical information, cost related information, treatment of various issues relating to Cost Records etc. The Cost Accounting Standards (CAS) issued by the Institute of Cost Accountants of India prescribes Principles of Measurement, Assignment of Costs or Revenue, Presentation & Disclosure requirements. The various items appearing in CRA-1 and various CASs are in sync with each other. In fact, when the new CCRAR were notified in 2014 most of the standards were in place. The requirements as regards maintenance of Records, measurement and assignment of costs / revenues, the principles for determination of costs go hand in hand in CRA-1 and CAS. Based on contents of CRA-1 for various elements, what kind of records need to be maintained by the company is outlined. It may be pertinent to note that no standardized formats are prescribed for maintenance of cost records by CRA-1. However, from the description of the record to be maintained one can contemplate the standard or normal record which should be maintained by the companies. Such common records are identified with the descriptive item and narrated under the column Cost Records. The records can be in the form of formatted and defined manner or various documents, and statements required to be compiled to meet the requirements of CRA-1 which will constitute the Cost Records.

While outlining the Cost Records, the reference of 'Methods' or 'System' may appear. It is not Cost Record per se but the company is required to maintain the record outlining the 'method' or 'system' or 'basis' as record being the requirement of CRA-1

Many of the points of CRA-1 for an item really do not speak of any record but they lay down the 'Principle' for treatment of that item in Cost Records.

The Cost Records mentioned in Column no. 2 are indicative in nature and in no way it can be construed as exhaustive list of Cost Records. Depending upon the business, its operations, the industrial practices, the system followed by particular organization the Cost Records may vary as regards its title, description, contents, formats and so on. All that information and database available in the company which gets used in compilation of cost statements and report may constitute the cost records of the company.

The cost records for a particular point within an item of cost or revenue can also be used for another point within the same item and hence it is not repeated for each point.

It will be the responsibility of the Internal Cost Auditor to check adherence to the Principles laid down in CRA-1, CAS and GACAP.

A tabular format is presented below with three columns.

1. CRA-1 Provision as it is.(there are 31 items)
2. Cost Record to be maintained.
3. Check point or Principle for ascertainment or treatment of cost / revenue / other items.

01. Material Cost

CRA 1 Point	**Cost Records**	**Check points or Principle**
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.	1. Material Requisition Note 2. Purchase Orders 3. Goods Receipt Note 4. Material Issue Note 5. Landed Cost Sheet 6. Stores Ledger 7. Bin Cards / Kardex 8. Material Return Notes 9. Material Transfer Notes 10. Material Sales Invoice	1. Material physical movement 2. Material accounting process 3. Material purchase rate effectiveness 4. Profit / loss incurred on sale of Material and its treatment in cost accounts
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.	1. Landed Cost for Domestic Materials 2. Landed Cost for Imported Materials	1. Landed Cost computation including and excluding the items specified. 2. Method for allocation / apportionment of common costs.
c) Finance costs incurred in connection with the acquisition of materials shall not form part of material cost.		Principle

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.	1. Cost computation statements for Self-manufactured and captively consumed materials	1. Principle 2. Captive consumption in different unit, rate of transfer is crucial, check whether at cost or transfer rate independent of cost and its impact on unit level profitability.
e) Spare parts shall be recognised as property, plant and equipment when they meet the definition of property, plant and equipment and depreciated accordingly. Otherwise, such items shall be classified as inventory.		1. Principle 2. Adherence to Ind AS 16
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.	1. Standards set for normal loss/spoilage in transit 2. Debit notes raised for excess losses / spoilages in transit 3. Records relating to disposal and recoveries	1. Principle 2. Accounting and recovery for spoilages and material losses
g)Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture etc., before the material	1. Standards set for normal loss/gain etc. in transit	1. Principle 2. Accounting for material losses and gains

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.		1. Principle
i) Any demurrage or detention charges, or penalty levied by transport or other authorities shall not form part of the cost of materials.	1. Record for incurrence of such cost with reasons and quantification	1. Principle
j)Subsidy or grant or incentive and any such payment received or receivable with respect to any material cost shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
k) Issues shall be valued using appropriate method as per the provisions contained in the accounting standard applicable for the time being in force.	1. Material accounting system 2. Notes to financial accounts	1. As per CAS -6 Para 5.2.1 FIFO, LIFO and WAR methods are recommended for valuation of issues.
l) Where materials are	1. Computation of Price	1. Principle

accounted at standard cost, the price variances related to materials shall be treated as part of material cost.	Variances 2. Separation of price variance from composite variance	
m) Any abnormal cost shall be excluded from the material cost.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
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.	1. Accounting, computation and allocation / apportionment of transport cost	1. Principle
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.	1. Cost computation statements for Self-manufactured and captively consumed components and sub-assemblies	1. Principle 2. Captive consumption in different unit, rate of transfer is crucial, check whether at cost or transfer rate independent of cost and its impact on unit level profitability.
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	1. Standards set for normal scrap or defectives 2. Record relating to cost being considered as abnormal 3. Criteria for determining 'abnormality' 4. Records relating to	1.Principle 2. Accounting and recovery for scrap and defectives.

exceeding the normal shall be adjusted in the material cost of good production. Material Cost of abnormal scrap or defectives should not be included in material cost but treated as loss after giving credit to the realisable value of such scrap or defectives.	disposal and recoveries	
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.	1. Bill of Material	1. Principle
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.	1. Identification of Material cost not directly traced to a cost object 2. Method used for allocation thereof to the cost object	1. Principle 2. Review of technical parameters used for allocation.
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.	1. Purchase Orders / Job Orders 2. Here material undergoes change and gets converted in a new / different product	1. Principle 2. Receipts should be booked under Material Cost.
t) Wherever part of the manufacturing operations or activity is	1. Job Orders 2. Here material remains the same and only some	1. Principle 2. Receipts should be booked under Direct

subcontracted, the subcontract charges related to materials shall be treated as direct expenses and assigned directly to the cost object.	processing is outsourced	Expenses.
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.	1. Identification of Indirect Material cost 2. Method used for allocation thereof to the cost object	1. Principle 2. Review of technical parameters used for allocation.
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.	1. Certification of estimation of production units from competent authority	1. Principle 2. Actual computation of 'charge' for the year in cost accounts 3. Actual charge in financial accounts 4. Difference between (2 & 3) above to be taken to P&L Reconciliation
w) The cost of indirect material with life exceeding one year shall be included in cost over the useful life of the material.	1. Certification of estimation of life in terms of year or quantitative units from competent authority	1. Principle 2. Actual computation of 'charge' for the year in cost accounts 3. Actual charge in financial accounts 4. Difference between (2 & 3) above to be taken to P&L Reconciliation

02. Employee Cost

CRA 1 Provision	**Cost Records**	**Check points or Principle**
a) Proper records shall be maintained in	1. Employee attendance register	Cost Records should be used for allocation

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.	2. Time sheet 3. Job card 4. Work order 5. Leave Record 6. Payroll with Gross pay and deductions 7. Overtime Record 8. Cost Centre wise, Department wise deployment of manpower and the associated costs 9. Methods of allocation for common employee cost to Cost centres 10. Labour productivity analysis 11. Categorisation of employees as permanent, temporary, casual, part time, trainee , apprentices and contract etc. records both in numbers and cost	of employee cost as direct and indirect, functional allocation, cost centre wise allocation etc 2. Records in no of employees over the period should be compared. 3. Labour efficiency and productivity should be checked.
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, including the cost of retirement benefits charged in the financial statements in an accounting period. In case of companies to which Indian Accounting Standards apply, any re-measurement of such costs recognised in other comprehensive	1. Schemes of Retirement benefits of the employees. 2. Assessment of liability for retirement benefit through sources such as actuarial valuation report 3. Computation of Employee Cost in Other Comprehensive Income	1. Principle 2. Actual cost to be considered in cost accounts 3. Actual charge in financial accounts 4. Difference between (2 & 3) above to be taken to P&L Reconciliation

income shall not form part of the employee cost.		
c) 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.	1. Computation of bonus 2. Computation of ex-gratia	1.Principle 2. Allocation of bonus and ex-gratia to Cost Centres
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.	1. Computation of remuneration MP & ED & Other Officers 2. Computation of remuneration of non-executive Directors	1.Principle 2. Allocation of remuneration to respective Cost Centres
e) Separation costs related to voluntary retirement, retrenchment, termination etc. shall be amortised over the period benefitting from such costs.	1. Documents relating to VR Schemes, Retrenchment notices, Terminations 2. Basis for determining charge for the year and period of amortisation-Management Certification for the same.	1. Principle 2. Charge for the year and amount taken to P&L Reconciliation.

f) Employee cost shall not include imputed costs.		1. Principle
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.	1. Computation of Idle time cost 2. Idle time analysis with reasons	1. Principle 2. Normal Cost of idle time to be absorbed 3. Abnormal Cost of idle time to be taken to P&L Reconciliation
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.	1. Standards set for employee cost 2. Computation of variances 3. Criteria for determining 'abnormality'	1. Principle 2. Normal variances to be absorbed 3. Abnormal variances to be taken to P&L Reconciliation
i) Subsidy or grant or incentive and any such payment received or receivable with respect to any employee cost shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
j) Any abnormal cost where it is material and quantifiable shall not form part of the Employee cost.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
k) Penalties, damages paid to statutory authorities or other third parties shall not form part of the Employee cost.	1. Record for incurrence of such cost with reasons and quantification	1. Principle

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.	1. Cost computation statement of employee related benefits	1. Allocation of benefits to respective Cost Centres
m) Any recovery from the employee towards any benefit provided, namely, housing shall be reduced from the employee cost.	1. Element wise details of Cost & Recovery	1. Principle 2. Employee related benefits to be considered at 'net value'
n) 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 a change would result in a more appropriate preparation or presentation of cost statements of an enterprise.	1. Certification from the management regarding change in Principles along with reasons and justification	1. Principle
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 etc. or similar identifiable measure.	1. Relationship between cost object and related costs through employee records mentioned above	1. The employee cost allocated to cost object.
p) While determining whether a particular Employee cost is chargeable to a separate cost object, the principle of materiality shall be	1. Company policy for determination of materiality	1. Adherence to the Policy

adhered to.		
q) 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.	1. Identification of employee cost not directly traced to a cost object 2. Method used for allocation thereof to the cost object	1. Principle 2. Review of parameters used for allocation.
r) 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 discontinue operations, shall not be treated as employee cost.	1. Certification from the management regarding discontinued operations along with reasons and justification	1. Principle 2. Charge for the year and amount taken to P&L Reconciliation. 3. Such amortised cost to be considered under Indirect cost.
s) Recruitment costs, training cost and other such costs shall be treated as overheads and dealt with accordingly.	1. Engagement letters issued to outside recruiting agencies 2. Training programs either in-house or outsourced	1. Principle
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.	1. Overtime payment analysis statement alongwith reasons for overtime	1. Principle 2. Relationship of overtime payment with cost object or otherwise. 3. Validation of justification for payment of overtime.
u) Idle time cost shall be assigned direct to the cost object or treated as overheads depending on the	1. Idle time analysis statement alongwith reasons for idle time	1. Principle 2. Relationship of idle time payment with cost object or otherwise.

economic feasibility and the specific circumstances causing such idle time.		3. Validation of justification for payment of idle time.

03. Utilities

CRA 1 Provision	Cost Records	Check points or Principle
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.	1. Periodical (normally monthly) quantitative and cost records of production or purchase of utilities 2. Cost centre wise quantitative consumption details	1. Variations from period to period or year on year basis alongwith the quantitative relationship with production or service. 2. Abnormalities in utilisation ratios alongwith explanations.
b) Each type of utility shall be treated as a distinct cost object.	1. Separate record For each utility	1. Principle
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.	1. Landed Cost for each utility	1. Landed Cost computation including and excluding the items specified. 2. Method for allocation / apportionment of common costs.
d) Cost of self-generated utilities for own consumption shall	Cost computation statements for Self-generated and own	1. Principle 2. Own consumption in different unit, rate

comprise direct material cost, direct employee cost, direct expenses and factory overheads.	consumed utilities	of transfer is crucial, check whether at cost or transfer rate independent of cost and its impact on unit level profitability.
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.	1. Distribution cost details for transfer of utilities	1. Principle
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.	1. Cost computation statements 2. Sales invoices	1. Principle 2. Profit / loss earned on such sales. 3. Impact on unit level profitability.
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.	1. Cost computation statements with inclusion of marketing overheads 2. Sales invoices	1. Principle 2. Profit / loss earned on such sales. 3. Impact on unit level profitability.
h) Finance costs incurred in connection with the utilities shall not form part of cost of		1. Principle

utilities.		
i) 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.	1. Distribution cost details for transfer of utilities	1. Principle
j) Cost of utilities shall not include imputed costs.		1. Principle
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.	1. Computation of Price Variances 2. Separation of price variance from composite variance	1.Principle
l) Subsidy or grant or incentive and any such payment received or receivable with respect to any cost of utilities shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
m) The cost of production and distribution of utilities shall be determined	1. Statement showing normal capacity – certification by management	1. Principle

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.	2. Statement showing cost based on normal capacity and actual cost giving rise to unabsorbed cost 3. Certification by management of standby utilities	
n) Any abnormal cost where it is material and quantifiable shall not form part of the cost of utilities.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
o) Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of utilities.	1. Record for incurrence of such cost with reasons and quantification	1. Principle
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.	1. Sales Invoices 2. Recovery Documents	1.Principle
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	1. Certification from the management regarding change in Principles along with reasons and justification	1. Principle

organisation.		
r) While assigning cost of utilities, traceability to a cost object in an economically feasible manner shall be the guiding principle.	1. Relationship between cost object and related Utility costs through records mentioned above	1. Principle 2. The Utility cost allocated to cost object.
s) Where the cost of utilities is not directly traceable to cost object, it shall be assigned on the most appropriate basis.	1. Identification of utility cost not directly traced to a cost object 2. Method used for allocation thereof to the cost object	1. Principle 2. Review of technical parameters used for allocation.
t) The most appropriate basis of distribution of cost of a utility to the departments consuming services is to be derived from usage parameters.	1. Quantitative Records for usage by different cost Centres / Departments etc.	1. Method adopted for Cost Distribution

04. Direct expense

CRA 1 Provision	Cost Records	Check points or Principle
a) Proper records shall be maintained in respect of direct expenses in such a manner as to enable 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.	1. Direct Expenses charged to Cost Objects 2. Direct Expenses charged to Cost Centres / Departments 3.Cost computation statements for each Direct Expense	1. Treatment of Cost in Cost Statements.
b) Direct expenses incurred for the use of bought out resources shall be determined at invoice or agreed price including duties and	1. Cost computation statements including and excluding the items specified	1.Principle

taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited.		
c) Other expenses shall be determined on the basis of amount incurred in connection therewith.		1. Method for allocation / apportionment of common costs.
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.	1. Basis for determining charge for the year and period of amortisation-Management Certification for the same.	1. Principle 2. Charge for the year and amount taken to P&L Reconciliation.
e) If an item of Direct Expenses does not meet the test of materiality, it can be treated as part of overheads.	1. Company policy for determination of materiality	1. Principle 2. Adherence to the Policy
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.		1. Principle
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	1. Computation of Price Variances 2. Separation of price variance from composite variance	1.Principle

not form part of the Direct Expenses.		
h) Subsidy or grant or incentive and any such payment received or receivable with respect to any direct expenses shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
i) Any abnormal portion of the direct expenses where it is material and quantifiable shall not form part of the Direct Expenses.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
j) Penalties, damages paid to statutory authorities or other third parties shall not form part of the Direct Expenses.	1. Record for incurrence of such cost with reasons and quantification	1. Principle
k) Credits or recoveries relating to the Direct Expenses, material and quantifiable, shall be deducted to arrive at the net Direct Expenses.	1. Sales Invoices 2. Recovery Documents	1. Principle
l) 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 a change would result in a more appropriate preparation or presentation of cost	1. Certification from the management regarding change in Principles along with reasons and justification	1. Principle

statements of an organisation.		
m) Direct Expenses that are directly traceable to the cost object shall be assigned to that cost object.	1. Relationship between cost object and Direct expense related costs through records	1. Principle 1. The Direct expense allocated to cost object.

05. Repairs and maintenance

CRA 1 Provision	Cost Records	Check points or Principle
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.	1.Cost Centre wise Cost accumulation Report 2. Policy for allocation of work shop etc. costs to Cost Centre / Departments 3. Quantification of service rendered	1. Adherence to the Policy
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.	1.Cost Centre wise Cost accumulation Report 2. Policy for allocation of Repairs and Maintenance cost to Cost Centre / Departments 3. Quantification of service rendered	1. Principle 2. Adherence to the Policy

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.	1. Repairs and Maintenance Job sheets/ Job orders 2.Policy for allocation of Repairs and Maintenance cost to Cost Centre / Departments	1. Adherence to the Policy
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.	1. Agreements with contractors 2. Resources provided to the contractor 3.Cost computation statements including cost of resources provided to the contractor	1. Adherence to the agreement
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.	1. Cost computation statements including and excluding the items specified	1.Principle

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.	1. Cost computation statements including and excluding the items specified	1.Principle
g) Each type of repairs and maintenance shall be treated as a distinct activity, if material and identifiable.		1.Principle
h) Cost of repairs and maintenance activity shall be measured for each major asset category separately.	1. Asset wise Repairs and maintenance carried out	1.Principle
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.		1.Principle
j)The cost of major overhaul shall be amortized on a rational basis.	1. Basis for determining charge for the year and period of amortisation-Management Certification for the same.	1. Principle 2. Charge for the year and amount taken to P&L Reconciliation.
k) Finance costs incurred in connection with the repairs and maintenance activities shall not form part of Repairs and maintenance costs.		1. Principle
l) Repairs and		1. Principle

maintenance costs shall not include imputed costs.		
m) 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.	1. Computation of Price Variances 2. Separation of price variance from composite variance	1.Principle
n) Subsidy or grant or incentive and any such payment received or receivable with respect to repairs and maintenance activity shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
o) Any repairs and maintenance cost resulting from some abnormal circumstances, e.g., major fire, explosions, flood and similar events, if material and quantifiable, shall not form part of the repairs and maintenance cost.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle

p) Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the repairs and maintenance cost.	1. Record for incurrence of such cost with reasons and quantification	1. Principle
q) 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.	1. Sales Invoices 2. Recovery Documents	1. Principle
r) 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 a change would result in a more appropriate preparation or presentation of cost statements of an organisation.	1. Certification from the management regarding change in Principles along with reasons and justification	1. Principle
s) Repairs and maintenance costs shall be traced to a cost object to the extent economically feasible.	1. Relationship between cost object and related costs through repairs and maintenance cost records mentioned above	1. Principle 1. The repairs and maintenance cost allocated to cost object.
t) 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	1. Identification of repairs and maintenance cost not directly traced to a cost object 2. Method used for allocation thereof to the cost object	1. Principle 2. Review of parameters used for allocation.

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.		
u) 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.	1.Policy for allocation of Repairs and Maintenance cost to Cost Centre / Departments	1. Adherence to the Policy

06. Fixed Assets and Depreciation

CRA 1 Provision	**Cost Records**	**Check points or Principle**
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.	1. Asset class wise Fixed Asset Register 2. Cost Centre wise Fixed Asset Register 3. Method of depreciation 4. Computation of depreciation 5. Policy for Depreciation	1. Adherence to the Policy
b) The depreciation and	1.Computation of Depreciation	1. Principle 2. Charge for the year

amortisation shall be the amount recognised as an expense for the year in the financial statements, which shall be measured as per the provisions contained in Schedule II of the Companies Act, 2013 and the accounting standards applicable for the time being in force. The amount of Depreciation and Amortisation not recognised as expense in the financial statements shall be treated as a non-cost item.	2.Certification of Assets identified as 'unused ' with reasons from the management 3. Basis for determining charge for the year and period of amortisation-Management Certification for the same.	and amount taken to P&L Reconciliation.
c) 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.	1. Certification of Assets identified as 'unused ' with reasons from the management	1. Principle
d) Impairment loss on assets shall be excluded from cost of production.	1. Certification of Assets identified as 'impaired ' with reasons from the management	1. Principle
e) Spare parts, stand-by equipment and servicing equipment shall be recognised as property, plant and equipment when they meet the definition of property, plant and equipment and depreciated accordingly.		1. Principle 2. Adherence to Ind AS 16

Otherwise, such items shall be classified as inventory.		
f) Depreciation shall be traced to the cost object to the extent economically feasible.	1. Relationship between cost object and Depreciation costs through Asset register	1. Principle 2. The Depreciation allocated to cost object.
g) 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.	1. Identification of Depreciation not directly traced to a cost object 2. Method used for allocation	1. Principle 2. Review of parameters used for allocation.

07. Overheads

CRA 1 Provision	Cost Records	Check points or Principle
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.	1.Cost Centre wise Cost accumulation Report 2. Policy for allocation of indirect expenses to Cost Centre / Departments	1. Adherence to the Policy
b) Overheads representing	1. Cost computation statements including and	1.Principle

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.	excluding the items specified	
c) Overheads other than those referred to above shall be determined on the basis of cost incurred in connection therewith.		1. Method for allocation / apportionment of common costs.
d) Any abnormal cost where it is material and quantifiable shall not form part of the overheads.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
e) Finance costs incurred in connection with procured or self-generated resources shall not form part of overheads.		1. Principle
f) Overheads shall not include imputed cost.		1.Principle
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.	1. Computation of Price Variances 2. Separation of price variance from composite variance	1.Principle
h) Subsidy or grant or incentive and any such payment received	1. The schemes from the State Government / Central Government /	1. Principle 2. Proper allocation between credit to

or receivable with respect to overheads shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	Local Authorities	current year cost and P&L Reconciliation
i) Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the overheads.	1. Record for incurrence of such cost with reasons and quantification	1. Principle
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.	1. Sales Invoices 2. Recovery Documents	1. Principle
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.	1. Certification from the management regarding change in Principles along with reasons and justification	1. Principle
l) While assigning overheads, traceability to a cost object in an economically feasible manner shall be the	1. Relationship between cost object and overhead related costs	1. Principle 1. The overhead cost allocated to cost object.

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. Works Overheads, also known as Production Overheads, Operation Overheads, Factory Overheads or Manufacturing Overheads, shall be the indirect costs involved in the production of a product or in providing service. Administrative overheads shall be the aggregate of cost of resources consumed in activities relating to general management and administration of an organisation. Selling and Distribution overheads shall be the aggregate of cost of resources consumed in the selling and distribution activities of the organization.	1. Statement of Functional Classification of Overheads 2. Cost Centre wise expenses booking	1. Variations from period to period or year on year basis alongwith the quantitative relationship with production or service. 2. Abnormalities in Cost centre wise costs alongwith explanations.
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	1. Identification of overheads not directly traced to a cost object 2. Method used for allocation	1. Principle 2. Review of parameters used for allocation.

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.	1. Statement showing identification of variable and fixed production overheads 2. Statement of computation of actual capacity utilisation	1. Principle
p) The fixed production overheads shall be absorbed based on the normal capacity.	1. Overhead absorption statement 2. Statement of computation of normal capacity utilisation	1. Principle
q) 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.	1. Lease agreements	1. Principle
r) Selling and Distribution Overheads, the benefits of which are expected to be derived over a long period, shall be amortized on a rational basis.	1. Basis for determining charge for the year and period of amortisation- Management Certification for the same.	1. Principle 2. Charge for the year and amount taken to P&L Reconciliation.
s) Any demurrage or detention charges or penalty levied by the transportation or other authorities in respect of	1. Record for incurrence of such cost with reasons and quantification	1. Principle

distribution activity shall not form part of Selling and Distribution Overheads.		

08. Administrative Overheads - Deleted

09. Transportation Cost

CRA 1 Provision	**Cost Records**	**Check points or Principle**
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.	1. Lorry Receipt 2. Insurance Certificates 3. Bill of Lading 4. Dock Receipt 5. Airway Bill 6. Seaway Bill 7. Guarantee Certificate 8. Bills from service providers 9. Bills / Debit Notes for recovery 10. Record relating to cost being considered as abnormal 11. Criteria for determining 'abnormality'	1. System for Cost accumulation and distribution
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	1. Cost computation statement for own transportation 2. Quantitative data of running of vehicles, goods transported 3. Log books for transport vehicles 4. Vehicle wise AMCs or other cost details	1. System for Cost accumulation and distribution

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.	1. Quantitative data of despatch of goods, running of vehicles 2. Agreement for transportation or service purchase order	1. System for Cost accumulation and distribution
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.	1. Log book for inward transportation 2. Log book for outward transportation	1. System for Cost accumulation and distribution
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	1. Log book for inward transportation 2. Log book for outward transportation separate for domestic and export	1. System for Cost accumulation and distribution

consumption and export.		
f) Records for transportation cost from factory to depot and thereafter shall be maintained separately.	1. Log book for outward transportation till depots point 2. Log book for outward transportation from depots to customer	1. System for Cost accumulation and distribution
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.	1. Log book for outward transportation to job workers place 2. Log book for inward transportation from job workers to factory	1. System for Cost accumulation and distribution
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.	1. Log book for inward transportation for trading 2. Log book for outward transportation for trading	1. Principle 2. System for Cost accumulation and distribution
i) Records of transportation cost directly allocable to a particular category of products shall be maintained separately so that allocation can be made.	1. Relationship between cost object and related Transportation costs through records mentioned above	1. Principle 2. The Transportation cost allocated to cost object.
j) For common transportation cost both for own fleet or hired ones, proper records for basis of apportionment shall be maintained.	1.Cost accumulation Report of common costs 2. Method used for apportionment of common costs	1. Review of parameters used for apportionment.

k) Records for transportation cost for exempted goods, taxable goods cleared for export shall be maintained separately.	1. Log book for outward transportation for exempted goods 2. Log book for outward transportation for taxable goods for export	1. Principle 2. System for Cost accumulation and distribution
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.	1. Log book for transportation by ship 2. Log book for transportation by air 3. Log book for transportation by rail	1. System for Cost accumulation and distribution
m) Inward transportation costs shall form the part of the cost of procurement of materials which are to be identified for proper allocation or apportionment to the materials or products.	1. Relationship between cost object and related transportation costs through records mentioned above 2. Method used for allocation	1.Principle 2. Review of technical parameters used for allocation.
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.	1. Relationship between cost object and related transportation costs through records mentioned above 2. Method used for allocation	1.Principle 2. Review of technical parameters used for allocation.
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: i) Weight ii) Volume of goods iii) Tonne-Km iv) Unit or Equivalent	1. Method used for apportionment	1. Review of technical parameters used for allocation.

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.		1. Principle
q) For determining the transportation cost per unit, distance shall be factored in to arrive at weighted average cost.		1. Principle
r) Abnormal and non-recurring cost shall not be a part of transportation cost.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle

10. Royalty and Technical Know-how

CRA 1 Provision	Cost Records	Check points or Principle
a) Adequate records shall be maintained showing royalty and 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.	1. Royalty and Technical Know-how agreements 2. Cost computation statement showing Royalty payable on production or sales separately and Technical Know-how payable on production	1. Adherence to agreement
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	1. Basis for determining charge for the year and period of amortisation-Management Certification for the same.	1. Principle 2. Charge for the year and amount taken to P&L Reconciliation.

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.		1. Principle
d) Subsidy or grant or incentive and any such payment received or receivable with respect to amount of royalty and technical know-how fee shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
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.	1. Record for incurrence of such cost with reasons and quantification	1. Principle

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.	1. Sales Invoices 2. Recovery Documents	1. Principle
g) 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.	1. Certification from the management regarding change in Principles along with reasons and justification	1. Principle
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: i) Units produced ii) Units sold iii) Sales value	1. Relationship between cost object and Royalty and Technical Know-how costs	1. Principle 1. The Royalty and Technical Know-how cost allocated to cost object.
i) The amount of Royalty fee paid for mining rights shall form part of the cost of material.	1. Royalty payment agreements	1. Principle
j) The amount of	1. Cost computation	1. Validity of the

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 it is related to trademarks or brands shall be treated as cost of sales.	statement showing Royalty and Technical Know-how payable on production or sales separately	agreement 2. Modification or changes in terms of agreement

11. Research and Development expense

CRA 1 Provision	Cost Records	Check points or Principle
a) 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. Relationship between cost object and related Research & Development costs through records mentioned below	1. Principle 1. The Research & Development cost allocated to cost object.
i The cost of materials and services consumed in Research and Development activities.	1. Material Issue Notes 2. Services consumed	
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,	1. Landed Cost for Materials 2. Invoices / Contracts for hired services	1. Landed Cost computation including and excluding the items specified.

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;	1. Cost Centre wise, Department wise deployment of manpower associated cost	
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;	1. Cost computation of depreciation / amortisation	
v. Overhead costs, other than general administrative costs, related to Research and Development activities.	1. Cost computation of Overheads	
vi. Costs incurred for carrying out Research, and Development activities by other entities and charged to the entity; and	1. Agreements / Contracts / Purchase Orders for outsourcing	
vii. Expenditure incurred in securing copyrights or licences	1. Agreements / Contracts / Purchase Orders for copyrights or licenses	
viii. Expenditure incurred for developing computer software	1. Agreements / Contracts / Purchase Orders for computer software	
ix. Costs incurred for the design of tools, jigs, moulds and dies	1. Cost computation	
x. Other costs that can be directly	1. Specific project cost computation	

attributed to Research, and Development activities and can be identified with specific projects.		
b) Subsidy or grant or incentive and any such payment received or receivable with respect to research and development activity shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
c) Any abnormal cost where it is material and quantifiable shall not form part of the Research and Development Cost.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
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.	1. Record for incurrence of such cost with reasons and quantification	1. Principle
e) Research and Development costs shall not include imputed costs.		1. Principle
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	1. Sales Invoices 2. Recovery Documents	1. Principle

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 & development costs that are not attributable to a specific product or process shall not form part of the product cost.	1. Relationship between cost object and R&D costs	1. Principle 1. The R&D cost allocated to cost object.
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".	1. Basis for determining charge for the year and period of amortisation-Management Certification for the same.	1. Principle 2. Charge for the year and amount taken to P&L Reconciliation.
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	1. Cost Computation statement of Research & Development costs for existing product & new product separately. 2. Basis for determining charge for the year and period of amortisation-Management Certification for the same.	1. Principle 2. Charge for the year and amount taken to P&L Reconciliation.

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.		
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.	1. Cost Computation statement 2. Sales Invoice	1. Profit / loss incurred on sale of Development costs and treatment in Cost Accounts

12. Quality control expense

CRA 1 Provision	Cost Records	Check points or Principle
a) Adequate records shall be maintained to indicate the expenses	1. Cost Centre wise, Department wise allocation of cost	1. Principle 2. Review of parameters used for

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.	2. Method used for allocation thereof to the cost object 3. Relationship between cost object and related Quality Control costs	allocation. 3. The Quality Control cost allocated to cost object.
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: (a) prevention cost; and (b) appraisal cost.	1. Job sheets/ Job orders 2.Policy for allocation of Quality Control cost to Cost Centre / Departments 3. Landed Cost of resources purchased	1. Adherence to the Policy 2. Landed Cost computation including and excluding the items specified.
c) Identification of Quality Control costs shall be based on	1. Relationship between cost object and related Quality Control costs	1. Principle 2. The Quality Control cost allocated

traceability in an economically feasible manner.	through records mentioned above	to cost object.
d) Quality Control costs other than those referred to above shall be determined on the basis of amount incurred in connection therewith.	1. Cost centre wise / Cost object wise booking	
e) Finance costs incurred in connection with the self-generated or procured resources shall not form part of Quality Control cost.		1. Principle
f) Quality Control costs shall not include imputed costs.		1. Principle
g) Subsidy or grant or incentive and any such payment received or receivable with respect to any quality control cost shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.54	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
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.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
i) Penalties, damages paid to statutory authorities or other third parties shall not form part of the Quality Control cost.	1. Record for incurrence of such cost with reasons and quantification	1. Principle
j) Any change in the	1. Certification from the	1. Principle

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.	management regarding change in Principles along with reasons and justification	
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.	1. Relationship between cost object and Quality Control costs	1. Principle 1. The Quality Control cost allocated to cost object.

13. Pollution Control cost

CRA 1 Provision	Cost Records	Check points or Principle
a) Adequate records shall be maintained to indicate the expenses	1. Cost Centre wise, Department wise allocation of cost	1. Principle 2. Review of parameters used for

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.	2. Method used for apportionment thereof to the cost object	allocation. 3. The Pollution Control cost allocated to cost object.
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 & 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.	1.Cost Centre wise Cost accumulation Report 2. Policy for allocation of Pollution Control cost to Cost Centre / Departments	1. Principle 2. Adherence to the Policy
c) 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.	1. Cost computation statement on accrued basis	1. Principle
d) Future remediation	1. Contracts or legal	1. Adherence to

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.	agreements 2. Cost computation statement showing disposal cost for current period & future period separately	Contracts or legal agreements
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.	1. Document related to legislative changes	1. Principle
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.	1. Identification of such costs	1. Observance of pollution control norms by the company
g) Social costs of pollution are measured by economic models of cost measurement. The cost by way of	1. Identification of such costs	1. Observance of pollution control norms by the company

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.	1. Job sheets/ Job orders 2.Policy for allocation of Pollution Control cost to Cost Centre / Departments	1. Adherence to the Policy
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.	1. Agreements with contractors 2. Resources provided to the contractor 3.Cost computation statements including cost of resources provided to the contractor	1. Adherence to the agreement
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),	1. Cost computation statements including and excluding the items specified	1.Principle

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.	1. Cost computation	1. Principle
l) Each type of Pollution Control e.g. water, air, soil pollution shall be treated as a distinct activity, if material are identifiable.		1. Principle
m) Finance costs incurred in connection with the Pollution Control activities shall not form part of Pollution Control costs.		1. Principle
n) Pollution Control costs shall not include imputed costs.		1. Principle
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	1. Computation of Price Variances 2. Separation of price variance from composite variance	1.Principle

Pollution Control cost. Usage variances attributable to abnormal reasons shall be excluded from Pollution Control cost.		
p) Subsidy or grant or incentive and any such payment received or receivable with respect to pollution control activity shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
q) Any Pollution Control cost resulting from abnormal circumstances, if material and quantifiable, shall not form part of the Pollution Control cost.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
r) Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the Pollution Control cost.	1. Record for incurrence of such cost with reasons and quantification	1. Principle
s) Credits or recoveries relating to the Pollution Control activity, material and quantifiable, shall be deducted to arrive at the net Pollution Control cost.	1. Sales Invoices 2. Recovery Documents	1. Principle
t) Research and development cost to develop new process, new products or use of		1. Principle

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 should 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.	1. Certification from the management regarding change in Principles along with reasons and justification	1. Principle
v) Pollution Control costs shall be traced to a cost object to the extent economically feasible.	1. Relationship between cost object and related Pollution Control costs through records mentioned above	1. Principle 2. The Pollution Control cost allocated to cost object.
w) Direct costs of pollution control such as treatment and disposal of waste shall be assigned directly to the product, where traceable economically.	1. Record relating to disposal of waste	1. Principle 2. Accounting of disposal cost
X) Where these costs are not directly traceable to the product but are traceable to a process	1. Identification of Pollution Control cost not directly traced to a cost object 2. Method used for	1. Principle 2. Review of parameters used for allocation.

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.	allocation thereof to the cost object	
a) 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.	1. Identification of Pollution control cost not directly traced to a cost object 2. Method used for allocation thereof to the cost object	1. Principle 2. Review of technical parameters used for allocation.

14. Service Department expense

CRA 1 Provision	Cost Records	Check points or Principle

a) Proper records shall be maintained in respect of Service Departments, i.e., 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 etc.	1. Cost Centre wise, Department wise allocation of cost 2. Method used for apportionment thereof to the cost object	1. Principle 2. Review of parameters used for allocation. 3. The Service Department cost allocated to cost object.
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.	1. Separate record for each service	1. Principle
c) Cost of service cost centre shall be the aggregate of direct and indirect cost attributable to services being rendered by such cost centre.	1.Cost Centre wise Cost accumulation Report 2. Policy for allocation of Service Department cost to Cost Centre / Departments 3. Quantification of service rendered	1. Principle 2. Adherence to the Policy
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.	1. Job sheets/ Job orders 2. Policy for allocation of Service Department cost to Cost Centre / Departments	1. Adherence to the Policy
e) Cost of other resources shall include related overheads.		1. Principle
f) Cost of services	1. Agreements with	1. Adherence to the

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.	contractors 2. Resources provided to the contractor 3.Cost computation statements including cost of resources provided to the contractor	agreement
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.	1. Cost computation statements including and excluding the items specified	1.Principle
h) Cost of services for the purpose of inter unit transfers shall also include distribution costs incurred for such transfers.	1. Distribution cost details for transfer of service	1. Principle
i) Cost of services for the purpose of inter-company transfers shall also include distribution cost incurred for such	1. Cost Computation statements 2. Sales Invoice	1. Principle 2. Profit / loss earned on such sales 3. Impact on unit level profitability.

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.	1. Cost Computation statements with inclusion of marketing overheads 2. Sales Invoice	1. Principle 2. Profit / loss earned on such sales 3. Impact on unit level profitability.
k) Finance costs incurred in connection with the Service Cost Centre shall not form part of the cost of Service Cost Centre.		1. Principle
l) The cost of service cost centre shall not include imputed costs.		1. Principle
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.	1. Computation of Price Variances 2. Separation of price variance from composite variance	1.Principle
n) Subsidy or grant or incentive and any such payment received or receivable with respect to any service cost centre shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation

as income.		
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.	1. Statement showing normal capacity – certification by management 2. Statement showing cost based on normal capacity and actual cost giving rise to unabsorbed cost 3. Certification by management of standby service	1. Principle
p) Any abnormal cost where it is material and quantifiable shall not form part of the cost of the service cost centre.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
q) Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of the service cost centre.	1. Record for incurrence of such cost with reasons and quantification	1. Principle
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.	1. Sales Invoices 2. Recovery Documents	1. Principle
s) Any change in the cost accounting principles applied for the measurement of the cost of Service Cost Centre shall be made,	1. Certification from the management regarding change in Principles along with reasons and justification	1. Principle

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.		
t) While assigning cost of services, traceability to a cost object in an economically feasible manner shall be the guiding principle.	1. Relationship between cost object and related Service Department costs through records mentioned above	1. Principle 2. The Service Department cost allocated to cost object.
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.	1. Identification of service department cost not directly traced to a cost object 2. Method used for allocation thereof to the cost object	1. Principle 2. Review of technical parameters used for allocation.
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 which could be related to the usage of the service rendered. The parameter shall be equitable, reasonable and consistent.	1. Methods used for allocation	1. Review of parameters used for allocation

15. Packing expense

CRA 1 Provision	Cost Records	Check points or Principle
a) Proper records shall be maintained	1. Packing Material Requisition Note	1. Packing Material accounting process

separately for domestic and export packing showing the quantity and cost of various packing materials and other expenses incurred on primary and or secondary packing indicating the basis of valuation.	2. Purchase Orders 3. Goods Receipt Note 4. Packing Material Issue Note 5. Landed Cost Sheet 6. Stores Ledger 7. Bin Cards / Kardex 8. Packing Material Return Notes 9. Packing Material Transfer Notes 10. Basis of identification of Primary and Secondary Packing Material	2. Packing Material purchase rate effectiveness
b) 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.	1. Landed Cost for Domestic Packing Materials 2. Landed Cost for Imported Packing Materials	1. Landed Cost computation including and excluding the items specified. 2. Method for allocation / apportionment of common costs.
c) Finance costs directly incurred in connection with the acquisition of Packing Material shall not form part of Packing Material Cost.		1. Principle
d) Self-manufactured packing materials shall be valued including direct material cost, direct	1. Cost computation statements for Self-manufactured and captively consumed packing materials	1. Principle 2. Captive consumption in different unit, rate of transfer is crucial,

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.		check whether at cost or transfer rate independent of cost and its impact on unit level profitability.
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.	1. Standards set for normal loss/spoilage in transit 2. Debit notes raised for excess losses / spoilages in transit 3. Records relating to disposal and recoveries	1.Principle 2. Accounting and recovery for spoilages and packing material losses
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.		1. Principle
g) Any demurrage, detention charges or penalty levied by the transport agency or		1. Principle

any authority shall not form part of the cost of packing materials.		
h) Subsidy or grant or incentive and any such payment received or receivable with respect to packing material shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
i) Issue of packing materials shall be valued using appropriate method as per the provisions contained in the accounting standard applicable for the time being in force.	1. Packing material accounting system	1. Relevant CAS- 9
j) Wherever, packing material costs include transportation costs, determination of costs of transportation shall be governed by Cost Accounting Standard on determination of average (equalized) cost of transportation.	1. Accounting, computation and allocation / apportionment of transport cost	1. Principle
k) Packing Material Costs shall not include imputed costs.		1. Principle
l) Where packing materials are	1. Computation of Price Variances	1.Principle

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.	2. Separation of price variance from composite variance	
m) The normal loss arising from the issue or consumption of packing materials shall be included in the packing materials cost.	1. Standard set for normal loss	1. Principle 2. Accounting for Packing Material losses
n) Any abnormal cost where it is material and quantifiable shall be excluded from the packing material cost.	1. Record relating to cost being considered as abnormal 2. Criteria for determining 'abnormality'	1. Principle
o) The credits or 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.	1. Sales Invoices 2. Recovery Documents	1. Principle
p) Packing material costs shall be directly traced to a cost object to the extent it is economically	1. Relationship between cost object and related Packing Material costs through records mentioned above	1. Principle 2. The Packing Material cost allocated to cost object.

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.	1. Identification of Packing cost not directly traced to a cost object 2. Method used for allocation thereof to the cost object	1. Principle 2. Review of technical parameters used for allocation.
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.	1. Technical estimates for usage / re-usage	1. Legal requirements / restrictions on re-usage
s) Cost of primary packing materials shall form part of the cost of production.		1. Principle
t) Cost of secondary packing materials shall form part of distribution overheads.		1. Principle

16. Interest and Finance Cost

CRA 1 Provision	Cost Records	Check points or Principle
a) Finance Costs 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.		1. Principle
b) Finance Costs incurred shall be identified for:	1. Cost computation statement showing Finance cost for working capital &	1. Principle

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.	term loan separately	
c) Finance Costs directly attributable to the acquisition or construction or production of a qualifying asset shall be included in the cost of the asset.		1. Principle
d) Finance Costs shall not include imputed costs.		1. Principle
e) Subsidy or grant or incentive and any such payment received or receivable with respect to finance costs shall be reduced from cost of the cost object in the financial year when such subsidy or grant or incentive and any such payment is recognised as income.	1. The schemes from the State Government / Central Government / Local Authorities	1. Principle 2. Proper allocation between credit to current year cost and P&L Reconciliation
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	1. Record for incurrence of such cost with reasons and quantification	1. Principle

the Finance Costs. 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;		1. Principle 2. Cost to be taken to P&L Reconciliation
h) Assignment of Finance Costs 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.	1. Identification of Finance cost not directly traced to a cost object 2. Method used for allocation	1. Principle 2. Review of parameters used for allocation.

17. Any other Item of Cost

CRA 1 Provision	Cost Records	Check points or Principle
Proper records shall be maintained for any other item of cost being indispensable and considered	1. Cost computation statement for Industry Specific Costs	1. Nature and necessity of such costs.

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

CRA 1 Provision	Cost Records	Check points or Principle
a) Capacity shall be determined in terms of units of production or services or equivalent machine or man hours.		1. Principle
b) Installed capacity is determined based on:	1. Statement showing Installed Capacity – Certification by management or concerned authority	1. Principle
i) Manufacturers' Technical specifications	1. Technical Literature from Manufacturer	
ii) Capacities of individual or interrelated production centres.		
iii) Operational constraints or capacity of critical machines or	1. List of bottleneck operations	
iv) Number of shifts		
c) In case manufacturers' technical specifications are not available, the	1. Addition / disposal of production facility 2. Certification by technical experts regarding changes in capacity from	1. Reasonableness of certified figures in comparison to actual utilisation 2. For major variations

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.	time to time	explanation from the management
d) Normal capacity shall be determined vis-a-vis installed capacity after carrying out following adjustments:	1. Statement showing Normal Capacity – Certification by management	1. Principle
i) Holidays, normal shut down days and normal idle time,	1. Analysis with reasons	
ii) Normal time lost in batch change over,	1. Analysis with reasons	
iii) Time lost due to preventive maintenance and normal break downs	1. Analysis with reasons	

of equipment,		
iv) Loss in efficiency due to ageing of the equipment, or	1. Analysis with reasons	
v) Number of shifts.	1. Labour law records	
e) Capacity utilization is actual production measured as a percentage of installed capacity.		1. Principle

19. WIP & FG

CRA 1 Provision	**Cost Records**	**Check points or Principle**
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	1. Material code wise quantitative and cost details of WIP & FG 2. Cost computation statement showing method used for valuation of WIP & FG and percentage completion in case of WIP	1. Principle 2. Actual Inventory value to be considered in cost accounts 3. Actual Inventory charged in financial accounts 4. Difference between (2 & 3) above taken to P&L Reconciliation

and finished goods shall be followed consistently.		

20. Captive Consumption

CRA 1 Provision	Cost Records	Check points or Principle
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.	1. Cost computation statement for captively consumed material showing quantity and Costs	1. Principle 2. Captive consumption in different unit, rate of transfer is crucial, check whether at cost or transfer rate independent of cost and its impact on unit level profitability.

21. Joint Product By Product

CRA 1 Provision	Cost Records	Check points or Principle
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	1. Stores Ledger 2. Realisation / realisable value of By-products 3. Sales Invoices for by-product sales	1. Principle

should be indicated in cost records. Records showing the expenses incurred on further processing, if any, as well as actual sales realization 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) 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 of credits or recoveries from the disposal of joint products or services.	1. Stores Ledger 2. Cost computation statements of Joint products 3. Basis adopted for separation of joint costs 4. Costs statements showing cost incurred after spilt of point	1. Principle 2. Review of technical parameters used for allocation.

22. Adjustments for Cost Variance

CRA 1 Provision	Cost Records	Check points or Principle
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 analysed 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.	1. Computation of cost element wise Variances 2. Computation of Price Variance and Quantity Variance separately with reasons 3. Costing Method used	1. Principle 2. Normal variances to be absorbed 3. Abnormal variances to be taken to P&L Reconciliation

23. Reconciliation of Cost and Financial Accounts

CRA 1 Provision	Cost Records	Check points or Principle
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.	1.Determination of items to be excluded as income or expense in cost records 2. The Cost accounting policy	1. Principle 2. Adherence to the Policy

24. Related Party

CRA 1 Provision	Cost Records	Check points or Principle
a) Related Party means related party as defined under sub-section 76 of section 2 of the Companies Act, 2013 (18 of 2013).	1. List of related parties as per Companies Act, 2013	1. Principle
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	1. Computation of Normal Price 2. Comparative statement showing price charged to related party and un-related party for same product / service	1. Principle

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 should 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; vi) Any other method, to be specified.	1. Methods adopted for computation of normal price	1. Principle
d) In respect of related party transactions or supplies made or services rendered by a company to a company termed "related party	1. Agreements or contracts with related parties for transactions specified	1. Principle 2. Adherence to Agreements or contracts

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 good(s), rendering of service(s), process materials and rejected goods including scraps, etc.; (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	1. Advanced Pricing Agreements 2. Export Sale Agreements / Sales Order 3. Import Purchase Agreements / Purchase Order	1.Comparitive prices of the competing parties 2. Customs duty database

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

CRA 1 Provision	Cost Records	Check points or Principle
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.	1. Cost computation statement of Export Sales 2. The schemes from the State Government / Central Government / Local Authorities related to Export	1. Adherence to scheme 2. Method for allocation / apportionment of common costs.
b) Proper records shall be maintained giving details of export commitments license-wise and the fulfilment 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.	1. Export Licenses 2. Duty free imports under duty exemption schemes	1. Cumulative statements of duty free imports and corresponding exports 2. Identifying the shortfall in export against commitment and duty liability for shortfall

If the duty free imports have been made after actual production, the statement shall reflect this fact also.		

26. Production Records

CRA 1 Provision	Cost Records	Check points or Principle
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.	1. Material Code wise, Plant / Unit wise Production Quantity Details 2. Separate details for self manufactured, third party manufactured etc.	1. Variations from period to period or year on year basis 2. Input / Output relationship

27. Sales Records

CRA 1 Provision	Cost Records	Check points or Principle
Separate details of sales shall be maintained for domestic sales at control price, domestic sales at	1. Sales register 2. Analysis of Sales Register 3. Sales Invoices 4. Debit notes / Credit notes	1. Reconciliation between Sales Register and Revenue from operations

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 under 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 centre wise for total as well as per unit sales realization.	5. Sales Returns	

28. Cost Statements

CRA 1 Provision	Cost Records	Check points or Principle
a) Cost statements (monthly, quarterly and annually) showing quantitative information in respect of each goods or service	1. Periodical (normally monthly) quantitative and cost statements	1. Variations from period to period or year on year basis alongwith the quantitative relationship with production or service. 2. Abnormalities in

under reference shall be prepared showing details of available capacity, actual production, production as per excise records, production as per GST records, capacity utilisation (in-house), stock purchased for trading, stock and other adjustments, quantity available for sale, wastage and actual sale, total quantity of outward supplies as per cost records and total outward supplies as per GST records during current financial year and previous year.		ratios alongwith explanations.
b) Such statements shall also include details in respect of all major items of costs constituting cost of production of goods and services, cost of sales of goods or services and margin in total as well as per unit of the goods and 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		1. Principle

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 or GST Credit utilised, duties or taxes recovered and interest or penalty paid.	1. GST Records and Returns like GSTR-1, GSTR-3B etc. 2. Excise Records and Returns like ER-1, ER-2 etc. 3. VAT Records and Returns	1. Reconciliation of Turnover as per Indirect Tax Returns & as per Financials 2. Reconciliation of Indirect tax payable & 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.	1. Plant wise Cost computation statements	1.Principle
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.	1. Statements not specifically mentioned in CRA-3 but are supportive for compilation of cost statements	1. Cost details in supportive statements and inclusion of such cost in CRA-3 cost statements

29. Statistical Record

CRA 1 Provision	Cost Records	Check points or Principle
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 analysed. Suitable records for computation of idle time of machines or labour shall also be maintained and analysed.	1. Standard set for Cost Centre wise / Department wise Machine Hours, Direct Labour Hours 2. Cost Centre wise / Department wise Computation of utilisation 3. Criteria for determining 'abnormality' 4. Reasons for idle time	1. Impact of under utilisation / shortfall, inclusion or exclusion in cost records
b)Proper records shall be maintained to enable 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	1. Books of account 2. Financial Accounts 3. Cost Statements 4. Asset additions showing purpose of addition 5. Unused Assets – Management Certification showing reasons	1. Principle 2. Internal system for asset addition

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 cost records. The records shall, in addition, show assets added as replacement and those added for increasing existing capacity.		

30. Records of Physical Verification

CRA 1 Provision	**Cost Records**	**Check points or Principle**
Records for physical verification may be maintained in respect of all items held in the stock such as raw material, 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	1. Type wise Material code wise Quantitative Physical inventory Record 2. Type wise Material code wise Quantitative inventory Record as per books 3. Shortage & Excess Quantitative statement with reasons for the same	1. Periodicity of Physical verification 2. Value impact of Shortage or Excess quantity in Financial Accounts & Cost Accounts

in the cost of the goods or services shall be indicated in the records.		

31. Unit of Measurement (UOM)

CRA 1 Provision	**Cost Records**	**Check points or Principle**
The Unit of Measurement (UOM) for each Customs Tariff Act Heading, wherever applicable, shall be the same as provided for in the Customs Tariff Act, 1975 (51 of 1975) corresponding to that particular Customs Tariff Act Heading.";	1. Customs Tariff Act	1. Classification of products / services under appropriate CTA.

CHAPTER –15 RECONCILIATION OF INDIRECT TAXES

The Companies (Cost Records and Audit) Amendment Rules, 2019 are notified on 15th October, 2019 Para D-6 relates to Reconciliation of Indirect Taxes. Since, it includes provisions relating to GST, for the benefit of the readers this chapter is included in this publication. Of course, these areas can very well be covered under the internal audit of cost records.

Introduction:

Since Goods and Service Tax (GST) has been rolled out w.e.f 01.07.2017, Part-D-6 annexure to Cost Audit Report i.e Reconciliation of Indirect Taxes (Company as a whole) was required some modification/editions. Cost Audit Branch (CAB) of Ministry of Corporate Affairs (MCA) has made necessary changes to the Part-D-6 annexure vide notification no GSR 792 (E) dt 15th Oct., 2019 and such changes/editions are applicable for and from F/Y 2018-19 onwards. The purpose and need for such changes are to prepare this annexure in line with the provisions of GST Acts.

This para gives reconciliation of GST payable and paid by the Company during the period under audit. This is to be reported for the Company as a whole. However, this information is required to be compiled for every unit separately registered under GST and then to be consolidated for the company. This enables the auditor to identify any mismatch in the reconciliation at unit level.

Relevant Definitions :

Some relevant definitions as per Central Goods and Services Tax Act are given below for reference :

Outward Taxable Supplies:

a) Section 2 (*83*) - "outward supply" in relation to a taxable person, means supply of goods or services or both, whether by sale, transfer, barter, exchange, licence, rental, lease or disposal or any other mode, made or agreed to be made by such person in the course or furtherance of business

b) Inward Taxable supplies liable to reverse charge (RCM):

Section 2 (*67*) - "inward supply" in relation to a person, shall mean receipt of goods or services or both whether by purchase, acquisition or any other means with or without consideration;

c) Reverse Charge :

Section 2 (*98*) - "reverse charge" means the liability to pay tax by the recipient of supply of goods or services or both instead of the supplier of such goods or services or both under sub-section (*3*) or sub-section (*4*) of section 9, or under sub-section (*3*) or sub- section (*4*) of section 5 of the Integrated Goods and Services Tax Act;

d) Zero Rated Supplies:

No definition is provided under GST for Zero Rated supply. But the term is used for export of goods and services with or without payment of IGST.

e) Transitional Credit:

Transitional Credit not defined under the GST law. But the same implies the carried over unutilized Cenvat Credit Balances as shown in Excise and Service tax returns and also the VAT balances carried over as shown in the vat returns. In other words, Transitional credit is the closing balances of Input Tax Credit under Excise, Service tax or VAT, as the case may be, as on 30.06.2017 which are carried forward to GST by filing Trans-1 form.

Part 6-D of Cost Audit Report –

Detailed analysis for the information to be compiled is given below :

A) Sr. No. 1 to 7 : Information relating to Excise, Service tax and VAT :

These Serial Numbers call for information relating to Excise Duty, Service Tax and Value Added Tax paid during the year under different headings like Domestic Sale, Export Sale, Stock Transfer etc.

The necessity of reporting these figures is on account of :

1) Even today, some products like Petrol and Petroleum products are covered under earlier Central Excise law and VAT laws. For those products, the information is required to be compiled in these parts. The basis of compilation of the information is the relevant returns filed under the Excise / VAT laws. This information is also required to be reconciled with books of accounts maintained by the assessee.

2) Also, those units working under GST, are required to pay the dues pertaining to period prior to July, 2017. Such Excise duty or VAT payments if made during the current year as a result of audit or appellate order or any investigation matter, the same is required to be reported in these parts.

It should be ensured by the Cost Auditor, if any such payment is made for the period prior to 1st July, 2017, the same should be considered in the Reconciliation and not to be charged off to Profit and Loss Account.
The above information is to be compiled under heads as – Taxable / Assessable value and Tax payable.

B) Information relating to GST :

This information is to be compiled and reported from Sr. No. 8 to 14.

- Information pertaining to Outward Taxable Supplies (Other than Zero rated (i.e. exports), Nil Rated and Exempted supplies) is to be shown at Sr. No. 8

- Information of Outward Zero Rated Supplies (i.e. exports) should be given at Sr No. 9. In this case, proper care should be taken to report exports on payment of IGST and exports without payment of IGST. Export under both the options should be reported in this column only.

- Inward supplies liable for reverse charge should be reported at Sr. No.10.
- Nil Rated and Exempted outward supplies are to be reported at Sr. No. 11.

-Non GST outward supplies are to be reported separately at Sr. No. 12. E.g. High Seas Sale, Sale of goods which are not imported in India but sold directly to third party outside India, alcohol, petrol and petroleum products etc.
- Sr. No. 13 and 14 are total of above columns and should be worked out as per the clarifications given in the para itself.

The above information is to be compiled under headings as – Taxable Value and tax payable under different headings viz. CGST, SGST and IGST, Cess and other levies, if any. This can be compiled from the GSTR-3B monthly returns filed by the assessee for the year. The same should be reconciled with the books of accounts also.

C) Duty / Taxes paid through Input tax Credit and cash :

Information of taxes paid is to be reported at Sr. No. 15 to 23. This can be complied from the GSTR-3B returns filed for the period.

Information of taxes paid through Input Tax Credit under different headings viz. CGST, SGST, IGST, Cess etc. is to be given separately. If the transitional credit is reversed during the year due to audit observation or for any such reason, the same should be reported in Sr. No. 19 under heading Transitional credit. Any payment of excise duty, VAT should be reported at Sr. No. 20 – Others and the same should be specified.

Sr. No. 21 is the total of payments shown at Sr. No. 15 to 20.

Sr. No. 22 gives information about taxes paid through Cash Ledger. This is also required to be compiled under different headings viz. CGST, SGST and IGST. This can be compiled from GSTR-3B returns filed for the period.

Sr. No. 23 is the total of payments made through Input Tax Credit (Sr. No. 21) and payments made through Cash Ledger (Sr. No. 22).

D) Difference between Taxes payable and taxes paid :

Difference in tax taxes payable (shown at sr. No. 14) and taxes paid (shown at Sr.No. 23) is to be reported in this section. This should be carefully reported. The taxes payable and paid must match. Ideally, there should not be any excess payment or short payment. In case of any difference, the same should be identified and confirmed, so that there is no wrong reporting.

E) Interest, Penalty, fines paid :

Any interest, penalty, fines paid during the year on account of reasons like audit queries, appellate orders, wrong availment of credit subsequently reversed with interest etc. should be reported at Sr. No. 23. **It should be ensured by the Cost Auditor that such payments are considered in the Reconciliation and not charged off to Profit and Loss Account.**

To Summarise :

The information should be compiled unitwise and then consolidated Companywise. The Taxes payable and paid should match. The information should be compiled from the GSTR-3B returns filed. If any errors are noticed in GSTR-3B returns filed, the information should be carefully prepared with due corrections so as to avoid any wrong or misleading information. The total Assessable value shown in this Para should be reconciled with total turnover to ensure that the figures are properly reported.

This information cannot be reconciled with the annual returns GSTR-9 and 9-C as the due date of approval of Cost Audit Report is on or before 27th September whereas the GST annual return filing due date is 31st December. Hence, these reports may not be readily available at the time of cost audit. If these are available, the cost auditor can reconcile the para D information with these returns also.