



BRIEF NOTE ON THE LEGAL PROVISIONS ON COST ACCOUNTING & COST AUDIT

Legal Provisions in the Companies Act, 1956

Sections 209(1)(d) and 233B were inserted in the Companies Act, 1956, by the Companies (Amendment) Act, 1965 (31 of 1965). These provisions relate to maintenance of cost accounting records and audit of cost records. Sections 209(1) and 233B read as under; full text of these sections is available at Appendix-I.

Section 209(1): *Every company shall keep at its registered office proper books of account with respect to -*

(a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place;

(b) all sales and purchases of goods by the company;

(c) the assets and liabilities of the company; and

(d) in the case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilization of material or labour or to other items of cost as may be prescribed, if such class of companies is required by the Central Government to include such particular in the books of account.

Whereas clauses (a), (b) and (c) of sub-section (1) of Section 209 deals with maintenance of financial books of account, clause (d) deal with the maintenance of cost accounting records.

Section 233B: *Where in the opinion of the Central Government it is necessary so to do in relation to any company required under clause (d) of sub-section (1) of section 209 to include in its books of account the particulars referred to therein, the Central Government may, by order, direct that an audit of cost accounts of the company shall be conducted in such manner as may be specified in the order by an auditor who shall be a cost accountant within the meaning of the Cost and Works Accountants Act, 1959.*

Justification & Implementation [in brief]

The justification for mandatory cost accounting records and cost audit has been well explained and documented in the Notes on clauses, Report of the Joint Select Committee and Parliamentary Debate that led to adoption of Companies Amendment Bill, 1965 incorporating above-mentioned Sections 209(1)(d) and 233B. The primary aim was to

make the corporate sector more efficient through the scheme of detailed cost accounting and efficiency audit. The scheme was intended to serve the best interest of the company itself and also of all other stakeholders including various Government agencies.

After the aforesaid amendments in the Companies Act, 1956, section 209(1)(d) was implemented by the Government in stages by notifying Cost Accounting Records Rules (CARRs) in 44 industries. List of these 44 industries is available at Appendix-II. Vested with the powers under section 233B, Government ordered for audit of cost accounting records in large number of companies falling within the scope of these 44 industries. In order to regulate the operation of section 233B, Government also notified Cost Audit Report Rules.

Review by various Committees

Extracts of the recommendations made by various Committees on the legal provision relating to cost accounting and audit are given in Appendix-III. Brief of each is given below.

- a) The “Expert Committee on New Company Law” (chaired by Dr. J.J. Irani) set up by the Ministry of Company Affairs, said that Cost Records and Cost Audit were important instruments that would enable companies make their operations efficient and exist in a competitive environment; and enabling provision may be retained in the law providing powers to the Government to cause Cost Audit.
- b) Committee on Subordinate Legislation (Fourteenth Lok Sabha) in its First Report (Chapter-III) said as follows:
 - Authentic cost data base is of paramount importance to various existing and new regulatory bodies, Competition Commission and Government Departments for fixation of user charges in respect of services provided by them and would go a long way in fulfilling their respective objectives.
 - In the present scenario authentic cost data base is not only essential for the industries to improve upon their performance and face competitive environment but is useful to various Government agencies, revenue authorities, regulatory bodies, banks and financial institutions for meeting their respective objectives.
 - Service sectors such as Banking, Insurance, Health Services, Education, Hotel, etc. have admittedly “attained strategic importance to the economy and the public at large, particularly after opening up of the economy for private/foreign companies”.

Absence of 'enabling' provision in the Companies Act should not be a reason for not prescribing CARRs for service industries. If the need for cost audit is otherwise found to be vital for service industries, the Committee emphasize that expeditious action should be taken to remove the lacuna in the Companies Act by suitably amending it.

The Companies Act, 2013 has included services under the provision relating cost accounting records and cost audit.

- c) Standing Committee on Finance in its report on the Companies Bill 2009 emphasized on mandatory maintenance of cost records, coverage of more number of companies, particularly in sectors concerning exploration, mining, processing, manufacturing, infrastructure and utilities under cost audit and due compliance with the cost accounting standards and cost auditing standards.

Keeping in view the aforesaid recommendations of the Committee on Subordinate Legislation as well as of the Standing Committee and also the recommendations made by the Expert Group set-up by MCA, Government introduced the reformed mechanism in the rules notified & orders issued in 2011.

Legal Provisions in the Companies Act, 2013

Full text of section 148 of the Companies Act, 2013 relating to cost accounting records and cost audit is reproduced in Appendix-IV. For proper understanding of its provisions, it should be read with few other sections that have significant bearings on the operation of the scheme of cost accounting and audit. These are section 2, 128, 134, 139 to 147, 398, 403, 458, 459, 469, 470 and schedule-III & IV.

Major variations in Section 148 of the Companies Act, 2013 vis-à-vis Sections 209(1)(d) and 233B of the Companies Act, 1956

For appreciation by the Committee, major variations in Section 148 of the Companies Act, 2013 vis-à-vis Sections 209(1)(d) and 233B of the Companies Act, 1956 are given below:

- a) In the scope, the words, "production, processing, manufacturing or mining activities" have been replaced with "production of such goods or providing such services".

Hence, the scope has been widened to include services that are in line with recommendations made by various Committees.

However, MCA will be required to incorporate compliance and monitoring mechanism for the prescribed class of companies.

- b) Proviso to sub-section (1) has been added which says that the Central Government shall, before issuing such order [i.e. orders for maintenance of cost accounting

records] in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

Presently, only the following classes of companies are regulated under a special Act:

- (i) Insurance companies regulated under the Insurance Act, 1938;*
- (b) Banking companies regulated under the Banking Regulation Act, 1949; and*
- (c) Electricity companies regulated under the Electricity Act, 2003.*

- c) As per the new provision, cost auditors shall be appointed by the Board [without prior approval of the Central Government] on such remuneration as may be determined by the members "**in such manner as may be prescribed**".

Hence, the government is now required to prescribe rules relating to cost auditors' appointment, remuneration, rotation, resignation, removal, re-appointment, period of holding of office etc.

- d) As per section 148 of the Companies Act, 2013, the cost auditor shall submit his report to the Board of Directors of the company and the company shall within thirty days furnish the same to the Central Government.

Thus as per the revised provisions, Central Government should prescribe the form of the report; time limit of submission of his report to the Board of Directors of the company; and monitoring mechanism for the cost auditor as well as for the company in the MCA.

- e) As per sub-section (3) of section 148 of the Companies Act, 2013, the auditor conducting the cost audit is required to comply with the cost auditing standards issued by the Institute of Cost Accountants of India with the approval of the Central Government.

*This is a positive development to improve quality of cost audit. However, reference to compliance with the cost accounting standards is provided under section 143 (3) (e) read with sub-section (14) *ibid*. This needs to be suitably incorporated in the Companies (cost records and audit) Rules, 2014.*

- f) Penalty provisions have also been modified in line with the general framework of the Companies Act, 2013.
- g) Sub-sections (9) and (10) of section 233B of the Companies Act, 1956 have been deleted.



Appendix-I

Section 209. BOOKS OF ACCOUNT TO BE KEPT BY COMPANY.

(1) Every company shall keep at its registered office proper books of account with respect to -

- (a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place;
- (b) all sales and purchases of goods by the company;
- (c) the assets and liabilities of the company; and
- (d) in the case of a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilization of material or labour or to other items of cost as may be prescribed, if such class of companies is required by the Central Government to include such particular in the books of account.

Provided that all or any of the books of account aforesaid may be kept at such other place in India as the Board of Directors may decide and when the Board of Directors so decides, the company shall, within seven days of decision, file with the Registrar a notice in writing giving the full address of that other place.

(2) Where a company has a branch office, whether in or outside India, the company shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns, made up to dates at intervals of not more than three months, are sent by the branch office to the company at its registered office or the other place referred to in sub-section (1).

(3) For the purposes of sub-sections (1) and (2), proper books of account shall not be deemed to be kept with respect to the matters specified therein, -

- (a) if there are not kept such books as are necessary to give a true and fair view of the state of the affairs of the company or branch office, as the case may be, and to explain its transactions; and
- (b) if such books are not kept on accrual basis and according to the double entry system of accounting.

(4) The books of account and other books and papers shall be open to inspection by any director during business hours.



(4A) The books of accounts of every company relating to a period of not less than eight years immediately preceding the current year together with the vouchers relevant to any entry in such books of account shall be preserved in good order:

Provided that in the case of a company incorporated less than eight years before the current year, the books of account for the entire period preceding the current year together with vouchers relevant to entry in such books of account shall be so preserved.

(5) If any of the persons referred to in sub-section (6) fails to take all reasonable steps to secure compliance by the company with the requirements of this section, or has by his own wilful act been the cause of any default by the company thereunder, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to ten thousand rupees, or with both:

Provided that in any proceedings against a person in respect of an offence under this section consisting of a failure to take reasonable steps to secure compliance by the company with the requirements of this section, it shall be a defence to prove that a competent and reliable person was charged with the duty of seeing that those requirements were complied with and was in a position to discharge that duty:

Provided further that no person shall be sentenced to imprisonment for any such offence unless it was committed wilfully.

(6) The persons referred to in sub-section (5) are the following, namely:-

- (a) where the company has a managing director or manager, such managing director or manager and all officers and other employees of the company; and
- (b) where the company has neither a managing director nor manager, every director of the company.

(7) If any person, not being a person referred to in sub-section (6), having been charged by the managing director, manager or Board of directors, as the case may be, with the duty of seeing that the requirements of this section are complied with, makes default in doing so, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to ten thousand rupees, or with both.

SECTION 233B. AUDIT OF COST ACCOUNTS IN CERTAIN CASES

(1) Where in the opinion of the Central Government it is necessary so to do in relation to any company required under clause (d) of sub-section (1) of section 209 to include in its books of account the particulars referred to therein, the Central Government may, by



order, direct that an audit of cost accounts of the company shall be conducted in such manner as may be specified in the order by an auditor who shall be a cost accountant within the meaning of the Cost and Works Accounts Act, 1959 (23 of 1959):

Provided that if Central Government is of opinion that sufficient number of cost accountants within the meaning of the Cost and Works Accountants Act, 1959, are not available for conducting the audit of the cost accounts of companies generally, that Government may, by notification in the Official Gazette direct that, for such period as may be specified in the said notification, such chartered accountant within the meaning of the Chartered Accountants Act, 1949, as possesses the prescribed qualifications, may also conduct the audit of the cost accounts of companies, and thereupon a chartered accountant possessing the prescribed qualifications may be appointed to audit the cost accounts of the company.

(2) The auditor under this section shall be appointed by the Board of Directors of the company in accordance with the provisions of sub-section (1B) of section 224 and with the previous approval of the Central Government:

Provided that before the appointment of any auditor is made by the Board, a written certificate shall be obtained by the Board from the auditor proposed to be so appointed to the effect that the appointment, if made, will be in accordance with the provisions of sub-section (1B) of section 224.

(3) An audit conducted by an auditor under this section shall be in addition to an audit conducted by an auditor appointed under section 224.

(4) An auditor shall have the same powers and duties in relation to an audit conducted by him under this section as an auditor of a company has under sub-section (1) of section 227 and such auditor shall make his report to the Central Government in such form and within such time as may be prescribed and shall also at the same time forward a copy of the report to the company.

(5) (a) A person referred to in sub-section (3) or sub-section (4) of section 226 shall not be appointed or re-appointed for conducting the audit of the cost accounts of a company.

(b) A person appointed, under section 224, as an auditor of a company, shall not be appointed or re-appointed for conducting the audit of the cost accounts of that company.

(c) If a person, appointed for conducting the audit of cost accounts of a company, becomes subject, after his appointment, to any of the disqualifications specified in clause (a) or clause (b) of this sub-section, he shall, on and from the date on which



he becomes so subject, cease to conduct the audit of the cost accounts of the company.

(6) Upon receipt of an order under sub-section (1), it shall be the duty of the company to give all facilities and assistance to the person appointed for conducting the audit of the cost accounts of the company.

(7) The company shall, within thirty days from the date of receipt of a copy of the report referred to in sub-section (4), furnish the Central Government with full information and explanations on every reservation or qualification contained in such report.

(8) If, after considering the report referred to in sub-section (4) and the information and explanations furnished by the company under sub-section (7), the Central Government is of opinion that any further information or explanation is necessary, that Government may call for such further information and explanation and thereupon the company shall furnish the same within such time as may be specified by that Government.

(9) On receipt of the report referred to in sub-section (4) and the informations and explanations furnished by the company under sub-section (7) and sub-section (8), the Central Government may take such action on the report, in accordance with the provisions of this Act or any other law for the time being in force, as it may consider necessary.

(10) The Central Government may direct the company whose cost accounts have been audited under this section to circulate to its members, along with the notice of the annual general meeting to be held for the first time after the submission of such report, the whole or such portion of the said report as it may specify in this behalf.

(11) If default is made in complying with the provisions of this section, the company shall be liable to be punished with fine which may extend to five thousand rupees, and every officer of the company who is in default, shall be liable to be punished with imprisonment for a term which may extend to three years, or with the fine which may extend to fifty thousand rupees, or with both.



Appendix-II

LIST OF COST ACCOUNTING RECORDS RULES

1. Cost Accounting Records (Cycles) Rules, 1967
2. Cost Accounting Records (Tyres & Tubes) Rules, 1967
3. Cost Accounting Records (Air-Conditioners) Rules, 1967
4. Cost Accounting Records (Refrigerators) Rules, 1967
5. Cost Accounting Records (Batteries other than Dry Cell Batteries) Rules, 1967
6. Cost Accounting Records (Electric Lamps) Rules, 1967
7. Cost Accounting Records (Electric Fans) Rules, 1969
8. Cost Accounting Records (Electric Motors) Rules, 1969
9. Cost Accounting Records (Aluminium) Rules, 1972
10. Cost Accounting Records (Vanaspati) Rules, 1972
11. Cost Accounting Records (Bulk Drugs) Rules, 1974
12. Cost Accounting Records (Jute Goods) Rules, 1975
13. Cost Accounting Records (Paper) Rules, 1975
14. Cost Accounting Records (Rayon) Rules, 1976
15. Cost Accounting Records (Dyes) Rules, 1976
16. Cost Accounting Records (Polyester) Rules, 1977
17. Cost Accounting Records (Nylon) Rules, 1977
18. Cost Accounting Records (Textiles) Rules, 1977
19. Cost Accounting Records (Dry Cell Batteries) Rules, 1978
20. Cost Accounting Records (Steel Tubes and Pipes) Rules, 1984
21. Cost Accounting Records (Engineering Industries) Rules, 1984
22. Cost Accounting Records (Electric Cables and Conductors) Rules, 1984
23. Cost Accounting Records (Bearings) Rules, 1985
24. Cost Accounting Records (Formulations) Rules, 1988
25. Cost Accounting Records (Steel Plant) Rules, 1990
26. Cost Accounting Records (Insecticides) Rules, 1993
27. Cost Accounting Records (Fertilizers) Rules, 1993
28. Cost Accounting Records (Soaps & Detergents) Rules, 1993



29. Cost Accounting Records (Cosmetics & Toiletries) Rules, 1993
30. Cost Accounting Records (Footwear) Rules, 1996
31. Cost Accounting Records (Shaving Systems) Rules, 1996
32. Cost Accounting Records (Industrial Gases) Rules, 1996
33. Cost Accounting Records (Sugar) Rules, 1997
34. Cost Accounting Records (Industrial Alcohol) Rules, 1997
35. Cost Accounting Records (Motor Vehicles) Rules, 1997
36. Cost Accounting Records (Cement) Rules, 1997
37. Cost Accounting Records (Milk Food) Rules, 2001
38. Cost Accounting Records (Mining and Metallurgy) Rules, 2001
39. Cost Accounting Records (Electronic Products) Rules, 2001
40. Cost Accounting Records (Electricity Industry) Rules, 2001
41. Cost Accounting Records (Plantation Products) Rules, 2002
42. Cost Accounting Records (Petroleum Industry) Rules, 2002
43. Cost Accounting Records (Telecommunications) Rules, 2002
44. Cost Accounting Records (Chemicals) Rules, 2004

Appendix-III**Extracts of Recommendation of various Committees****Expert Committee on New Company Law (chaired by Dr. J.J. Irani)**

“At present, the Companies Act contains provision relating to maintenance of Cost Records u/s 209(1)(d) and Cost Audit u/s 233B of the Companies Act in respect of specified industries. The Committee felt that Cost Records and Cost Audit were important instruments that would enable companies make their operations efficient and exist in a competitive environment.

The Committee noted that the present corporate scenario also included a sizeable component of Government owned enterprises or companies operating under administrative price mechanism or a regime of subsidies. It would be relevant for the Government or the regulators concerned with non-competitive situations to seek costing data. The Committee, therefore, took the view that while the enabling provision may be retained in the law providing powers to the Government to cause Cost Audit, legislative guidance has to be taken into account the role of management and addressing cost management issues in context of the liberalized business and economic environment. Further, Government approval for appointment of Cost Auditor for carrying out such Cost Audit was also not considered necessary.”

Committee on Subordinate Legislation (Fourteenth Lok Sabha), First Report (Chapter-III)

“3.12 The Committee regret to note that even 38 years after enactment of the relevant provisions empowering the Government to prescribe Cost Accounting Records Rules (CARRs), these have not been framed to cover all major industries/projects. CARRs have so far been notified only in respect of 47 industries. The slow pace of framing rules negates the very purpose of the important provisions of the legislation passed by the Parliament. Though it has been contended that the legislation is “enabling” and is not “mandatory”, the Secretary, Department of Company Affairs indicated during evidence that at one point of time priority had been assigned to certain industries in the preparation of CARRs. He admitted that out of the prioritized industries for which CARRs should have been in position, five major industries have been left out, notably among them being the Coal Industry. It is strange that the Department of Company Affairs could not ascertain the reasons why CARRs could not be framed for a major industry such as “Coal” all these years. The Secretary, Department of Company Affairs has assured that the Department would now be writing to Ministries concerned regarding formulation of CARRs and

prioritize Industries/Services on the basis of urgency expressed by them. The Committee would like to be apprised of the action taken in this regard and the time frame laid down by the Department for completing the task.

3.13 Service sectors such as Banking, Insurance, Health Services, Education, Hotel, etc. have admittedly “attained strategic importance to the economy and the public at large, particularly after opening up of the economy for private/foreign companies”. It has been stated that an authentic cost data base is of paramount importance to various existing and new regulatory bodies, Competition Commission and Government Departments for fixation of user charges in respect of services provided by them and would go a long way in fulfilling their respective objectives. The existing provisions of the Companies Act, however, do not require formulation of CARRs for service industries. The Committee feel that absence of ‘enabling’ provision in the Companies Act should not be a reason for not prescribing CARRs for service industries. If the need for cost audit is otherwise found to be vital for service industries, the Committee emphasize that expeditious action should be taken to remove the lacuna in the Companies Act by suitably amending it.

3.14 The Committee are concerned to note that the Department of Company Affairs do not have a definite idea about the relevance and significance of CARRs in the present day scenario of liberalization and globalization. The Department have held out two different views before the Committee. In a note submitted to the Committee, the Department opined that the main objective of cost audit when introduced was mainly to meet Government requirements for regulating the price mechanism in certain industries and that in the present scenario authentic cost data base is not only essential for the industries to improve upon their performance and face competitive environment but is useful to various Government agencies, revenue authorities, regulatory bodies, banks and financial institutions for meeting their respective objectives. The Secretary, Department of Company Affairs, however, quoted during evidence another school of thought according to which the competitive regime which is now in vogue calls for companies to be competitive, cost conscious and secretive if they have to on a continuous edge. This view advocates dilution of CARRs to the extent of eliminating them from the statute. The Committee note that one of the objects of the Companies (Second Amendment) Bill, 1964, [which on enactment became Companies (Amendment) Act, 1965] as stated in the Statement of Objects and Reasons appended to the Bill, was “to strengthen the provisions relating to investigation into the affairs of Companies and to provide for more effective audit in dealing with cases of dishonesty and fraud in the corporate sector”. In view of a number of cases of financial irregularities in the corporate sector recently coming to light, the Committee finds it difficult to subscribe to this school of thought. The Committee feels that holding divergent views and lack of

clear policy about CARRs is not conducive to the functioning of the Department. The Committee urge that the Department of Company Affairs in consultation with Ministries and regulators concerned should examine thoroughly from all angles the need and importance of the Cost Accounting Records Rules in the present day scenario and lay down clear, coherent and unambiguous policy guidelines in regard to CARRs.”

Standing Committee on Finance [in its report on the Companies Bill, 2009]

- *Keeping in view the significance of cost control for industry, the Ministry may consider appropriate coverage of corporate sector for mandatory maintenance of cost records.*
- *Appointment of Cost Auditor should be made by the shareholders of the company in their annual general meeting, as in the case of statutory auditors, instead of the Board of Directors as proposed in the Bill.*
- *The Central Government should retain the power to institute cost audit in larger companies, whenever circumstances so warrant, particularly in sectors concerning exploration, mining, processing, manufacturing, infrastructure and utilities.*
- *Modification of relevant sub-clauses to include cost accounting standards and cost auditing standards.*

Appendix-IV

Section 148. Central Government to specify audit of items of cost in respect of certain companies.

(1) Notwithstanding anything contained in this Chapter, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies:

Provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

(2) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

(3) The audit under sub-section (2) shall be conducted by a cost accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed:

Provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records:

Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards.

Explanation.—For the purposes of this sub-section, the expression "cost auditing standards" mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959 (23 of 1959), with the approval of the Central Government.

(4) An audit conducted under this section shall be in addition to the audit conducted under section 143.

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



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

(6) A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section (2) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

(7) If, after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub-section (6), the Central Government is of the opinion that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

(8) If any default is made in complying with the provisions of this section,—

(a) the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;

(b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.
