STRATEGIC COST AUDIT: A TOOL FOR TRANSFORMING COMPLIANCE INTO COMPETITIVE INTELLIGENCE

Abstract

In the highly competitive Indian Manufacturing sector, particularly the Automobile industry, the traditional compliance focused cost audit mandated by the Companies Act, 2013 (**Statutory Rules, 2014)** is insufficient for sustained success. This article posits the central hypothesis that pivoting the cost audit function from a statutory obligation to a strategic intelligence tool is essential for mitigating margin erosion and leveraging competitive advantage **(Plutus Education, 2023).** Through case study analysis, the article demonstrates that strategic costing models, such as Activity-Based Costing (ABC), are crucial for determining true product costs, correcting margin misstatements of up to 2.36% **(Automobile Study, 2016).** Also, the audit provides verified data for critical strategic decisions, including Make-or-Buy planning **(Kulkarni & Jenamani, 2008)** and Target Costing for new product development (Narsaiah, 2019). Amidst the disruptive shift to Electric Vehicles (EVs), the audit's mandate extends to Life Cycle Costing (LCC), enabling resilient pricing **(Bain & Company, 2023).** Ultimately, the integration of verified cost data into a Strategic Cost Management Framework (SCMF) is imperative for operational efficiency **(ICMAI Report, 2023).**

CMA Rajendra Kumar Joshi
Senior Vice President (Strategy & Planning)
Jio Platforms Limited
New Delhi
joshirk@rediffmail.com

Section 1: The New Competitive Imperative for Indian Manufacturing

1.1. The Indian Automobile Paradox and Export Constraint

The Indian automobile industry is recognized globally for its scale and engineering depth (CSEP**, 2025**). While domestic PV sales increased by 48% between 2019–20 and 2024–25, export growth lagged significantly at only 16% (**CSEP, 2025**). This paradox suggests internal cost metrics may not align with global realities. Errors in calculating "true unit costs," often resulting from Traditional Cost Accounting (TCA), can render products non-viable. When executed strategically, the cost audit must act as an 'Export Readiness Check,' verifying that cost structures are competitive (**Automobile Study, 2016**).

1.2. Intensified Cost Pressures and International Context

The sector faces complex shifts, with SUVs now capturing over 50% of the PV market and regulatory changes like TREM 5 raising tractor costs by ₹1–1.5 lakh (**Kotak/SIAM, 2025**). To manage this, India must look to international benchmarks. Unlike Germany's cost control standards or Japan's lean costing models which are often voluntary cultural practices, India possesses a unique advantage in its statutory cost audit framework. This legal mandate should be leveraged to enforce the same rigor in cost accuracy that global competitors achieve

through internal discipline.

1.3. Cost Audit: The Pivot from Compliance to Strategic Necessity

The cost audit, mandated under Section 148 of the Companies Act, 2013 (Statutory Rules, 2014), has evolved from a regulatory burden to a "business necessity" (**Plutus Education, 2023**). The verified foundation of cost data provided by the audit is indispensable for investors and government, ensuring the reliability of data necessary for competitive pricing (**Plutus Education, 2023**).

1.4. Methodology and Scope

This is a conceptual and analytical paper grounded in secondary data and case analysis. It builds a logical strategic framework from the mandatory Cost Accounting Records Rules (CRA-1) compliance to actionable Strategic Cost Management Framework (SCMF) recommendations, focusing specifically on the challenges and opportunities within the Indian Automobile sector. The paper is mainly focused on leveraging the statutory cost audit taking reference of Indian Automobile sector's constraints and use of data to alleviate that. The Paper doesn't aim to involve in comparative study but consider it significant and recommend as future work.

Section 2: Building the Foundation: Cost Accuracy and Operational Control

2.1. Ensuring Data Integrity: The CRA-1 Mandate

The basis of strategic cost management is auditable data, structured by the Cost Accounting Records Rules (CRA-1) mandate (**SSCO India, 2025**). This mandates a well-maintained system for tracking cost elements like materials, labour, overheads, and depreciation. For manufacturing entities, accurate recording at every production stage is non-negotiable; operational failure to maintain CRA-1 records not only risks penalties but fundamentally compromises the reliability of internal data, undermining all subsequent managerial efforts (**SSCO India, 2025**).

2.2. Leveraging Audit Data for Production Regulation and Waste Reduction

Beyond compliance, the cost audit functions as a powerful operational monitoring tool, providing essential data to regulate production, detect errors, and reduce resource wastage (**ICMAI Report, 2023**). This proactive function facilitates the constant reviewing and monitoring of procedures, identifying both visible and invisible losses, inefficiencies, wastages, and time overruns **(ICMAI Report, 2023**). By systematically identifying these deviations, the audit enables immediate rectification and effective implementation of cost reduction systems (**ICMAI Report, 2023**).

2.3. Multi-Plant Profitability Comparison and Benchmarking

For large Indian OEMs operating multiple facilities, the cost audit provides the standardized, verified data necessary for horizontal benchmarking and comparing profitability across different plants (**ICMAI Report, 2023**). Strategic leaders can use this data to differentiate between *structural* advantages (e.g., location, depreciation) and *controllable operational* inefficiencies (e.g., resource wastage, time overruns) (**ICMAI Report, 2023; SCMF Analysis, 2024**). This process allows for targeted intervention strategies based on verifiable intra-firm comparisons.

Section 3: Strategic Costing for Optimization and Product Decisions

3.1. Correcting the Flaw: Migration to Activity-Based Costing (ABC)

Strategic decision-making requires moving beyond Traditional Cost Accounting (TCA), which often assigns indirect costs arbitrarily, leading to inaccurate product costing (**Automobile Study, 2016**). Activity-Based Costing (ABC) is designed to assign costs accurately to the activities that consume resources, generating the true cost of a product (**Automobile Study, 2016**).

A case-based comparative study in an Indian automobile parts manufacturer highlighted the inaccuracy of TCA. For instance, TCA overstated the profit margin for Part 'B' by 2.36% while simultaneously understating the true margin for Part 'A' by 2.08% (Automobile **Study, 2016**).

Table 1: Comparative Study TCA Vs ABC

Product	Traditional Cost Accounting (TCA) Margin	Activity-Based Costing (ABC) True Margin	Misstatement (Absolute)	Implication
Part 'B'	27.50%	25.14%	2.36% Overstatement	Risk of underpricing due to inflated margin
Part 'A'	25.41%	27.49%	2.08% Understatement	Risk of incorrect product mix optimization

Source: Automobile Study, 2016

These findings confirm that strategic decisions based on TCA data are fundamentally flawed, leading to misguided pricing and resource allocation. By deploying ABC, verified through the cost audit, companies gain clarity to optimize their product mix and direct production toward items yielding the highest true returns (**Automobile Study, 2016**).

3.2. Strategic Sourcing: The Make-or-Buy (MoB) Framework

The Make-or-Buy (MoB) decision complexly impacts profitability and competitive resilience (**Kulkarni & Jenamani, 2008**). Strategic MoB frameworks require the simultaneous consideration of costs, core competences, and inherent risk (**Kulkarni & Jenamani, 2008**). The cost audit verifies the internal "cost to make" using accurate ABC data. The framework, developed for the Indian automobile sector, explicitly suggests the decision point where risk evaluation is necessary during the MoB process (**Kulkarni & Jenamani, 2008**). A crucial strategy is *partial outsourcing*, where firms maintain a "make" capability to retain know-how and mitigate dependence or supplier opportunism, a strategy leveraged by companies like Rico Auto and Sundaram fasteners (**MSE Working Paper, 2021**). The cost audit verifies the financial justification for maintaining this internal strategic capacity (**Kulkarni & Jenamani, 2008**).

Section 4: Advanced Costing Tools: Target Costing and Life Cycle Costing (LCC)

[SECTIONS 4 AND 5 MERGED PER PEER REVIEW]

4.1. The Necessity of Target Costing

In the price-sensitive Indian market, Target Costing is a critical approach that focuses on achieving profitability before production begins (**Narsaiah, 2019**). This reverses the traditional cost accumulation model, focusing on reducing costs *prior* to allocating productive resources (**Narsaiah, 2019**). The process involves:

- Determining the target sales price and desired profit (**Al Adwan et al., 2018**).
- Ascertaining the maximum allowable target cost.
- Executing cost investigation across processes (**Al Adwan et al., 2018**).
- Ascertaining the *expected cost* using detailed models.
- Conducting comparative analysis to close the cost reduction gap (**Al Adwan et al., 2018**).

The cost audit's role is to validate the 'Expected Cost' (Step 4) against verifiable cost records. This ensures that strategies used to close the gap rely on sustainable, auditable cost reductions, such as value engineering or optimized sourcing (**Tata Motors Report, 2013**).

4.2. Value Engineering and Continuous Improvement

Leading Indian OEMs, such as Tata Motors, recognize that continuous cost reduction is essential for improving revenue and strategic market position, employing practices like value engineering and formalized supplier cost reduction programs (**Tata Motors Report, 2013**). Value engineering requires a granular cost breakdown, which the cost audit verifies for accuracy and reliability. Furthermore, the audit institutionalizes a vital feedback loop: Inefficiencies identified during a compliance audit

such as specific instances of resource wastage or time overruns (**ICMAI Report, 2023**) must be fed back into the Target Costing model for New Product Development (NPD). This systematic integration ensures that operational variances (short-term) refine the cost assumptions for future products (long-term), driving continuous cost reduction (**SCMF Analysis, 2024**).

4.3. Life Cycle Costing (LCC) for Electric Vehicles (EVs)

The structural shift to electric mobility, driven by tightening emission norms, presents unique cost complexities, particularly with the battery accounting for the majority of the vehicle's initial price (**Bain & Company, 2023**). The higher upfront cost of EVs necessitates reliable residual value management programs, such as buybacks, to mitigate consumer apprehension and offer liquidity comfort (**Bain & Company, 2023**). Traditional cost models are insufficient for this sector. The strategic model required is Life Cycle Costing (LCC), which holistically evaluates all costs associated with the entire lifespan of the EV, including operational costs and eventual disposal/recycling (**EV Costing Analysis, 2020**). LCC models, when accurately developed and verified, serve two purposes: they calculate the Total Cost of Ownership (TCO) to prove the EV's long-term financial advantage, and they form the financial basis for residual value management programs (**Bain & Company, 2023; EV Costing Analysis, 2020**).

The Strategic Imperative

The statutory cost audit is no longer a compliance burden—it is the essential engine of competitive intelligence. Discover how verified cost data is mandatory for Indian manufacturers to mitigate margin erosion and secure competitive pricing against global rivals, ensuring long-term profitability and market resilience

4.4. Specialized Cost Auditing for EV Components

For manufacturers of EV components, especially batteries, cost auditing requires specialized alignment with high-technology production and volatile material markets (**SSCO India, 2025**). The focus is rigorous tracking of critical cost elements like lithium and lead, mandatory under CRA-1 (**SSCO India, 2025**). Auditors must ensure management prepares detailed, product-wise cost sheets that correctly segregate material usage, conversion costs, and margin analysis for distinct product categories, such as two-wheeler batteries versus four-wheeler EV packs (**SSCO India, 2025**). Relying on lump-sum figures leads to inaccurate competitive pricing and non-compliance (**SSCO India, 2025**). This granular, verified tracking also serves as a crucial hedge against global commodity price volatility by enabling rapid strategic adjustments (**SSCO India, 2025**).

Section 5: Synthesis and Actionable Recommendations

5.1. Developing a Strategic Cost Management Framework (SCMF)

Sustained competitive advantage requires formal integration of cost audit findings into a Strategic Cost Management Framework (SCMF) (**SCMF Analysis, 2024**). This framework emphasizes robust cost analysis for informed decision models, incorporating risk and uncertainty through scenario analysis and sensitivity testing (**SCMF Analysis, 2024**).

Table 2: Strategic Decision using Audited Cost Data: An Analysis

Strategic Decision Area	Cost Audit Output/Data Used	Competitive Advantage Achieved
Operational Efficiency	Deviation from standards, resource wastage reports, multi-plant profitability comparison **(ICMAI Report, 2023).**	Continuous reduction of expenses, enhanced productivity, efficient resource allocation.

Strategic Decision Area	Cost Audit Output/Data Used	Competitive Advantage Achieved
Capacity Planning	Component true cost analysis (ABC), core competency assessment, risk evaluation points (**Kulkarni & Jenamani, 2008**).	"Optimal Make-or-Buy decisions, reduced supplier opportunism.
Competitive Pricing	Accurate product/service unit cost (ABC verified), target cost variance analysis (**Automobile Study, 2016**).	Proactive margin protection, value-based pricing, and successful export penetration.
NPD & EV Strategy	Life Cycle Cost (LCC) modelling parameters, material tracking (**SSCO India, 2025**).	Design for target cost, verifiable residual value management, mitigated LCC risk.

5.2. Actionable Recommendations for Indian Automobile/Manufacturing Leaders

- **Mandate ABC Implementation:** Leadership must mandate the full transition from TCA to Activity-Based Costing (ABC) across all operations, using the statutory cost audit as the enforcement mechanism to guarantee the reliability of 'true cost' data required for production mix optimization (**Automobile Study, 2016**).
- **Formalize Make-or-Buy Re-evaluation:** Establish a protocol requiring mandatory re-evaluation of significant sourcing decisions every three years. This must utilize a multi-factor framework that simultaneously considers verified costs, core competency retention, and supply chain risk, with verified audit data forming the basis of the cost analysis (**Kulkarni & Jenamani, 2008**).
- **Integrate Global Benchmarking:** The strategic review accompanying the statutory cost audit report (CRA-3) should include a formalized section benchmarking key product unit costs against relevant global competitors. This practice helps identify and eliminate the margin errors (e.g., 2% to 3% misstatement) that impede export success (**CSEP, 2025; Automobile Study, 2016**).
- **Adopt Life Cycle Costing (LCC) for New Platforms:** For all New Product Development (NPD), especially in the EV sector, LCC must replace unit cost accounting as the primary model for pricing and strategic planning. The cost audit must verify the engineering and financial assumptions underlying the LCC model, particularly relating to battery costs and residual value guarantees (**Bain & Company, 2023; EV Costing Analysis, 2020**).

Costing for Disruption
Learn how applying advanced strategic costing techniques, like Activity-Based Costing (ABC) and Life Cycle Costing (LCC), provides the verifiable 'true cost' required for optimal production decisions and resilient pricing strategies in India's volatile Electric Vehicle (EV) market

Conclusion: Securing Long-Term Resilience

In the highly competitive and evolving Indian manufacturing landscape, the ability to control costs and make profitable pricing decisions is directly tied to the accuracy of internal cost information. By embracing the cost audit not merely as a necessary compliance function but as a powerful source of verified strategic intelligence, manufacturers can correct fundamental flaws in cost allocation, optimize resource utilization, and develop resilient pricing strategies. This transformation secures the long-term profitability and market success of

Indian industry leaders amidst dynamic competitive pressures. MA

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