

COST AUDIT: ENHANCING TRANSPARENCY, EFFICIENCY AND STRATEGIC DECISION – MAKING LINKAGE OF COST AUDIT WITH GST COMPLIANCE AND INPUT TAX CREDIT VERIFICATION

Abstract

The Goods and Services Tax (GST) regime in India has redefined the indirect tax framework, emphasizing compliance, transparency, and accurate credit flow through Input Tax Credit (ITC) mechanism. Concurrently, cost audit as mandated by the Companies (Cost Records and Audit) Rules, 2014, assures the reliability and integrity of cost records. This convergence of cost audit and GST compliance creates a comprehensive framework for improving governance, verifying ITC claims, and supporting strategic financial decision-making. This article explores the linkage between cost audit and GST compliance, focusing on ITC verification, internal controls synergies, and data reconciliation mechanisms. By aligning cost audit procedures with GST documentation and ITC verification processes, organizations can reduce tax risk, strengthen compliance, and enhance cost efficiency. Recent regulatory updates have further reinforced this integration, promoting both statutory conformity and financial discipline. The article also explores the transformative potential of emerging technologies such as Artificial Intelligence and blockchain in automating ITC verification, alongside the pivotal role of professional bodies in developing standardized, technology-driven compliance frameworks.



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Introduction

The implementation of the Goods and Services Tax (GST) in India on 1 July 2017 represented a major reform in indirect taxation. GST consolidated multiple levies into a unified tax system, introducing the mechanism of Input Tax Credit (ITC) to avoid the cascading effect of taxes. In parallel, cost audit—administered under Section 148 of the Companies Act, 2013 and the Companies (Cost Records and Audit) Rules, 2014—aims to verify cost records, ensure cost control, and promote managerial efficiency. Given that cost records capture the same transaction trail as GST documentation—covering inputs, services, and consumption—the two systems naturally intersect. Linking cost audit with GST compliance can provide deeper insights into tax governance and operational efficiency, particularly in validating ITC claims.

GST Compliance and Input Tax Credit: An Overview

1. Concept and Importance of ITC

The ITC mechanism allows registered taxpayers to offset the tax paid on inputs (goods or services) against their output tax liabilities, provided all documentation and compliance requirements are met. To claim ITC, the taxpayers must:

- ◎ Possess a valid tax invoice or debit note.
- ◎ Actual receipt of goods/services.
- ◎ Ensure the supplier has filed GST returns (GSTR-1, 3B) and paid the taxes to the government.
- ◎ Use the input for business purposes related to taxable supplies.

Correct ITC utilization improves liquidity and reduces cost accumulation, making it a critical compliance and cost-management component.

2. Key Compliance Requirements under GST

Key compliance practices include:

- ◎ Filing GSTR-1 (Outward Supply), GSTR-3B (summary return), and annual returns (GSTR-9/9C).
- ◎ Reconciling purchase records with suppliers' data in GSTR-2A/2B.
- ◎ Reversing ITC for exempt/non-business purposes.
- ◎ Retaining records for at least 72 months from the due date of the annual return.

Non-compliance leads to interest, penalty or reversal of ITC, affecting working capital and profitability.

Cost Audit: Role and Relevance

1. Definition and Scope

Cost audit refers to the verification of cost records and accounts maintained by an organization to ensure accuracy, propriety, and adherence to cost accounting principles. It is governed by the Companies (Cost Records and Audit) Rules, 2014.

2. Objectives

- ◎ Verify cost data and cost allocation methods.
- ◎ Ensure cost efficiency, control, and reduction

of waste.

- ◎ Facilitate transparency for managerial decision-making.
- ◎ Ensure regulatory compliance with cost accounting standards.

3. Relevance to GST/ITC

- ◎ Cost audit examines purchase, consumption, and usage records—datasets also used for GST compliance.
- ◎ Thus, the cost audit acts as a complementary check to GST verification, especially in validating ITC claims based on accurate consumption and utilization data.

4. Applicability of Cost Audit Across Industries

Cost audit is mandated under Section 148 of the Companies Act, 2013 and the Companies (Cost Records and Audit) Rules, 2014. It applies to specific industries based on **turnover thresholds** and the nature of business activity.

General Threshold for Cost Audit Applicability:

- ◎ Companies engaged in prescribed products or services must maintain cost records if:
 - ▲ Total turnover from all products/services is **₹35 crore or more** during the immediately preceding financial year.
- ◎ Cost audit becomes **mandatory** if:
 - ▲ The company's overall turnover is **₹100 crore or more**, and
 - ▲ The turnover of individual products or services covered under cost audit rules is **₹35 crore or more**

Industries Covered Under Cost Audit Regulations:

- ◎ **Manufacturing Industries:** Required to maintain cost records to ensure accurate input consumption and GST Input tax credit reconciliation.
- ◎ **Electricity Generation and Distribution:** Cost audit is mandatory due to the regulated nature of their costs and extensive use of inputs subject to GST.

- ◎ **Mining and Mineral Processing:** Companies engaged in mining coal, ores, and minerals are liable for cost audit because of the significant input cost components and GST compliance related to extracted goods.
- ◎ **Pharmaceuticals and Chemicals:** Given the complexity of inputs, services, and compliance requirements, cost audit ensures transparency and accuracy in cost and GST ITC verification.
- ◎ **Cement, Steel, and Heavy Engineering:** These capital-intensive sectors require cost audits to verify the cost structures for regulatory and GST reporting integrity.
- ◎ **Telecom and Infrastructure Companies:** Firms in telecom and infrastructure development often fall under cost audit norms due to significant capital expenditure and recurring input supplies.
- ◎ **Automotive and Transport:** Vehicle manufacturers and transport companies are subject to cost audits to ascertain cost management and reliable ITC claims.
- ◎ **Textiles and Apparel:** Textile mills and garment manufacturing units are included due to raw material usage needing reconciliation with GST ITC.

5. Recent Developments in ITC Governance (Budget 2025–26 Perspective)

The Union Budget 2025–26 strengthens ITC verification by integrating e-invoicing systems and automating reconciliation through GSTR-2B. Businesses adhering to cost audit norms will benefit from smoother ITC processing. Automation reduces mismatches, enables real-time verification, and incentivizes transparent record-keeping. These reforms underline the government's intention to

“Integrating cost audit with GST compliance ensures accurate ITC verification, reduces tax disputes, and enhances financial governance through stronger data reliability and transparent cost controls”

link statutory audit systems with tax compliance reporting.

6. Role of Cost Auditors in Strengthening GST Compliance

Cost auditors are pivotal in ensuring that the organization's cost structures and tax claims align accurately. Their professional responsibility under Section 148 includes assessing supplier compliance, validating input claims, and identifying errors or duplication in ITC records. By collaborating with tax teams, cost auditors enhance the quality of internal controls and facilitate effective tax governance. ICMAI can play a significant role in developing standard reporting formats and checklists to align cost audit practices with GST compliance verification. Such efforts could lead to regulatory recognition of cost audit reports as supporting documentation for ITC verification and departmental assessments. (1)

7. Role of Cost Audit During GST Audits and Legal Proceedings

In cases of departmental audits or show-cause notices by GST authorities, the **Cost Audit Report (CRA-4)** serves as vital documentary evidence. It supports businesses through:

- ◎ **Evidence Through Reconciliation** - The comprehensive reconciliation of turnover, output, and input costs documented in the cost audit provides concrete proof to tax authorities, validating the accuracy of GST returns submitted.
- ◎ **Legal Credibility in Proceedings** - Being a formal and statutory document, the cost audit report holds admissibility in judicial and quasi-judicial forums, thereby reinforcing a company's position in tax litigation
- ◎ **Effective Resolution of Valuation Issues** - Cost audit findings serve as an authoritative reference for the correct valuation of goods and services, helping companies effectively

counter challenges related to under- or over-valuation in GST assessments.

Linkage of Cost Audit with GST Compliance and ITC Verification

1. Common Data Framework

The cost audit process and GST compliance share a common data foundation, enabling seamless verification and reconciliation. The following table highlights the alignment between cost audit records and corresponding GST data sources:

Cost Audit Data	Corresponding GST Data
Raw Material Purchases	Supplier Invoices (GSTR-2A/2B)
Services Consumed	Input Service ITC Ledger
Production and Consumption Records	ITC Utilization against Output Supplies
Overheads/Shared Costs	ITC Apportionment for Mixed Supplies

This integrated data framework facilitates accurate matching of cost records with GST filings, ensuring transparency, consistency, and reliability in Input Tax Credit (ITC) verification.

2. Verification of ITC Eligibility

Cost audit ensures that:

- ⦿ Inputs recorded in cost books are used for taxable supplies.
- ⦿ Ineligible ITC (e.g., personal use, exempt supplies) is identified and reversed as per Rule 42 and 43 of the CGST Rules, 2017.
- ⦿ Input services are properly linked with production and overheads, enabling apportionment accuracy.
- ⦿ Capital goods ITC is claimed correctly without double counting or inclusion in depreciation.

This helps prevent over-claiming and ensures strong audit preparedness.

3. Reconciliation and Control

Cost audit procedures can reconcile:

- ⦿ Cost ledger entries with ITC claimed in

GSTR-3B.

- ⦿ Purchase register with GSTR-2A/2B data.
- ⦿ Consumption records with production and sales turnover to verify proportional ITC claims.

Regular reconciliation minimizes mismatches between cost accounts and GST filings, thus preventing ITC reversals and disputes.

4. Internal Control and Risk Mitigation

Cost audit contributes to internal control evaluation by:

- ⦿ Verifying supplier GST registration and compliance status.
- ⦿ Ensuring that invoice processing workflows prevent erroneous ITC claims.
- ⦿ Identifying areas of leakage (e.g., missed ITC due to unclaimed invoices).
- ⦿ Providing management assurance that cost and tax data are synchronized.

5. Strategic Decision-Making

Cost audit findings, when integrated with GST/ITC data support:

- ⦿ Procurement decisions (choosing compliant suppliers).
- ⦿ Pricing strategies (factoring ITC benefits).
- ⦿ Cash-flow planning (based on eligible ITC).
- ⦿ Product costing models (accurate cost-plus tax pricing).

Illustrative Example: ITC Apportionment through Cost Records

Consider a manufacturing entity that avails a service costing ₹1,00,000 + 18% GST which is used for both taxable and exempt products. If 70% of the entity's turnover relates to taxable supplies, the eligible Input Tax Credit will be : $\text{₹18,000} \times 70\% = \text{₹12,600}$.

The cost audit process ensures:

- ⦿ **Identification of cost drivers:** Allocation of expenses to the correct cost centres or activities.
- ⦿ **Accurate ITC reflection:** Proper recording

in ITC apportionment registers.

- ◎ **Regulatory compliance:** Adherence to **Rule 42 of the CGST Rules**, requiring reversal of ₹5,400 as ineligible ITC.

Such reconciliation not only prevents excess ITC claims but also strengthens the company's position during departmental scrutiny or audit verification.

Legal Precedents Reinforcing the Role of Cost Audit in GST Compliance

Recent judicial pronouncements have reinforced the evidentiary value of cost audit reports in GST compliance and litigation. Courts have increasingly recognized cost audit data as credible support for Input Tax Credit (ITC) claims and valuation accuracy.

- ◎ **Vidya Drolia vs. Union of India (2023):**

The Supreme Court upheld ITC as a *vested right*, emphasizing that compliant taxpayers should not be penalized for supplier defaults when transactions are supported by verifiable records, including cost audits.

- ◎ **Brij Systems Ltd vs. Union of India (2025):** The Supreme Court ruled that ITC cannot be denied due to suppliers' clerical or filing errors when cost audit reconciliations substantiate genuine transactions.

- ◎ **Simon India Ltd vs. State of Odisha (Orissa High Court):** Allowed cost audit reports and reconciliations as admissible evidence during GST audits, helping taxpayers defend adverse findings through verified cost data

Framework for Integrating Cost Audit and GST Compliance

A structured integration of cost audit procedures with GST verification ensures consistency, accuracy, and control over indirect tax compliance. The following framework outlines the key steps involved in achieving this alignment:

Step	Activity	Purpose
1	Pre-audit planning – include GST/ITC as an audit objective	Define the scope to cover GST risk areas, ITC validation, and reconciliation requirements.

2	Mapping of cost records with GST invoices	Establish clear linkage between cost elements and GST documentation for accurate data matching
3	Verification of ITC claim documents	Ensure eligibility of Input Tax Credit through document scrutiny and cross-verification.
4	Reconciling between cost audit reports & GST returns	Identify, analyze, and rectify mismatches in turnover, inputs, and tax credits.
5	Reporting discrepancies and recommendations	Provide management with actionable insights to improve compliance and cost efficiency.
6	Ongoing dashboard monitoring	Enable continuous tracking of GST and cost data for sustained regulatory compliance.

An integrated approach allows the cost auditor to enhance both statutory compliance and operational efficiency.

Benefits and Challenges of Integrating Cost Audit with GST Compliance

1. Benefits

- ◎ **Transparency:** Unified verification of cost and tax records.
- ◎ **Compliance Assurance:** Reduces risk of GST non-compliance and ITC disputes.
- ◎ **Cost Efficiency:** Detects leakages in ITC claims or duplicate payments.
- ◎ **Decision Support:** Enables tax-informed costing and pricing strategies.
- ◎ **Audit Synergy:** Reduces duplication between GST audit and cost audit processes.

2. Challenges

- ◎ **Complexity of Data:** High transaction volume and multi-location entities complicate reconciliation.
- ◎ **Frequent Regulatory Changes:** Dynamic GST notifications require regular updates to

audit methodology.

- ◎ **Lack of Integration:** ERP and accounting systems may not fully align cost modules with GST ledgers.
- ◎ **Resource and Training Needs:** Cost auditors require updated GST knowledge for effective linkage reviews.

Way Forward: Strategic Directions for Integrating Cost Audit and GST Compliance

- ◎ **Digital Integration:** Develop ERP dashboards linking cost records, supplier compliance, and ITC tracking.
- ◎ **Standardized Checklists:** ICMAI may issue standard audit checklists combining cost audit and GST verification points. (1)
- ◎ **Training & Capacity Building:** Periodic workshops for cost auditors on GST law and ITC apportionment.
- ◎ **Regulatory Collaboration:** Encourage dialogue between cost audit and tax authorities to recognize cost audit reports as supporting documentation for ITC verification.
- ◎ **Data Analytics:** Use data analytics in cost audit to detect anomalies in ITC claims, such as unusual credit ratios or supplier non-filing patterns.
- ◎ **Technological Integration:** Future integration of Artificial Intelligence (AI) and blockchain in audit trails can automate ITC verification and cost data validation. Such technologies can create tamper-proof audit records, reducing compliance errors and improving traceability.

Conclusion

Cost audit and GST compliance, though separate statutory functions, share a unified goal—ensuring transparency, efficiency, and integrity in business

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Cost audit-driven ITC validation empowers businesses with improved compliance, operational efficiency, and strategic decision-making, transforming statutory requirements into measurable cost and tax advantages

operations. The linkage between cost audit and Input Tax Credit verification creates a strong compliance mechanism strengthens audit assurance and supports strategic cost management.

Integrating cost audit with GST documentation helps businesses validate ITC eligibility, avoid non-compliance, and achieve comprehensive financial governance. The synergy of cost audit expertise with GST compliance frameworks can thus transform cost verification from a statutory formality into a strategic management

tool, enhancing both profitability and compliance reliability in the post-GST era.

Additionally, integrating of cost audit with GST compliance prepares businesses for evolving regulations and digital tax systems. This synergy enhances financial governance and operational agility, making organizations more resilient. Ongoing collaboration among auditors, tax authorities, and continuous skill development are essential to maximize the benefits of this integrated framework. **MA**

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