CHAPTER – IV
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STATUTORY COST AUDIT IN INDIA

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The Statutory cost audit was introduced for the first time in India by an amendment of the Companies Act in 1965.

The Duftri-Shastry Committee and the Vivian Bose Enquiry Commission felt that the then existing provisions in the Companies Act were not adequate to check the malpractices in the manufacturing, processing or mining companies. As such the Companies Act was amended.

According to Section 209(1) (d) of the Companies Act, the Central Government may require certain companies engaged in manufacturing, processing, production or mining, to keep books of accounts pertaining to utilization of materials, labour and other items of cost as may be prescribed. Section 209(1) (d) is reproduced below:

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 ............

(2) In the case of a company pertaining to any class of companies engaged in production, processing, manufacturing, or mining activities, such particulars relating to utilisation 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 particulars in the books of account.

On perusal of the above section, it is clear that all the industries engaged in manufacturing, processing or mining, etc., are not required to keep the books of account, but only such companies or class of
companies would do so as are required by the Central Government, as a regular feature. The Central Government has by now directed some 42 industries to keep books and maintain cost accounts. The Central Government has framed Cost Accounting Record Rules pertaining to each industry which are required to keep cost accounts and records according to this Section. To name a few, such industries are: Cement, Cycle, Caustic soda, Tyres and tubes, Room air-conditioners, Refrigerators, Electric lamps, Electric fans, Electric motors, Fluorescent tubes, Automobile batteries, Motor vehicles, Tractors, Aluminum, Vanaspati, Bulk drugs, Sugar, Infant milk food, Industrial alcohol, Jute goods, Paper, Rayon, Dyes, Soda ash, Cotton Textiles, Polyester, Nylon, Dry cell batteries, Sulphuric Acid, etc. Many more industries will be covered in course of time if the Central Government so desires.

4.1 Cost Accounting Records Rules

These rules, as referred to above, provide guide lines to the companies to maintain their cost records. These rules may differ from industry to industry according to the nature of the industry. Some of the main heads under which the cost data are to be compiled are given below:

1. Materials: The records of material received, issued, consumed, lost in transit or wasted in storage, their pricing or valuation are to be given.

2. Consumable Stores, small tools and machinery, spares, etc.: The receipts, issues, balances, losses, etc., are to be recorded. Items which have not moved for more than 24 months are to be reported.

3. Power, fuel, steam etc.: Full records are to be kept to ascertain the costs of consumption. In the case of purchase of power or steam,
purchase cost is to be shown separately. The allocation of cost of power to departments is also to be shown.

4. Wages and salaries: Attendance of workers and staff, departments where each is working, system of remuneration and bonus, allocation of wages, idle-time costs, over-time costs etc., are to be shown.

5. Service department costs: These costs are to be worked out and their apportionment to production is to be shown.

6. Depreciation: Depreciation charged should not be less than what is provided in Section 205(2) of the Companies Act.

7. Royalty and payment of technical assistance: The basis of calculating and charging royalty and other payments should be shown.

8. Overheads: Their classification, basis of apportionment, method of absorption are to be shown separately for production, administration, selling and distribution, along with overhead costs attributable to each type of product.

9. Work-in-progress: Opening and closing W.I.P., their valuation method and costs, physical checking records, etc.

10. Reconciliation of cost and financial books: It is to be done periodically and recorded.

11. Stock-verification: Tallying of balances shown by Bin-Cards and Stores Ledger Accounts, physical checking reports, perpetual inventory system, stock valuation, wastage or loss or pilferage, etc. The method of compiling costs for each industry is given in the proforma attached to the rules pertaining to each industry. The observance of the rules and maintenance of cost accounting records prelude to statutory cost audit.
4.2 Provisions Regarding Statutory Audit

Section 233B of the Companies Act empowers the Central Government to institute Statutory Cost Audit in any company to which Section 209(1) (d) applies. It should be noted that all the companies covered under section 209 are not subject to statutory audit. Only such companies are subject to cost statutory audit as are required by the Central Government to do so and which are covered by Section 209(1)(d). Section 233B is reproduced below:

Section 233-B, 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 Accountant Act, 1959 (23 of 1959)]

Provided that if the Central Government is of opinion that sufficient number of cost accountants within the meaning of the Cost and Works Accountants Act, 1959 (23 of 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.

1. Inserted by the Companies (Amendment) Act, 1965.
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(38 of 1949), as possesses the prescribed qualifications, may also conduct the audit of cost accounts of companies, and thereupon a Chartered accountant possessing the prescribed qualifications may be appointed to audit the costs 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 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.

2. Substituted by the Companies (Amendment) Act, 1974.

3. Sub-section (2) substituted by the Companies (Amendment) Act, 1988, S. 35. The existing sub-sec. (2) stood as follows: "(2) the auditor under this section shall be appointed by the Board of Directors of the company, with the previous approval of the Central Government."

(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 qualifications 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 information's and explanations furnished by the company under sub-section (7) and sub-section (8), the Central Government may take such action on the -

5. Inserted by the Companies (Amendment) Act, 1974.
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 notice of 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 fine which may extend to five thousand rupees, or with both.

4.3 Appointment, Powers and Duties of Statutory Cost Auditor

As per Section 233 B of the Companies Act, the cost auditor is to 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. His remuneration is also fixed by Board of Directors.

[According to section 224(1B), no company or its Board of directors shall appoint or re-appoint any person who is in full time employment elsewhere or firm as its auditor if such person or firm is, at the time of such appointment or re-appointment, holding appointment as auditor of the specified number of companies or more than the specified number of companies.]
A Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959 is eligible to be appointed as cost auditor. In the event of shortage of cost auditors possessing requisite qualifications, as above, the Central Government may, by notification, direct that Chartered Accountants with prescribed qualifications may be appointed for such period as may be specified in the notification, to carry out cost audit.

An auditor appointed under Section 224 cannot be appointed as Cost Auditor for the same company, and vice versa. (Section 224 relates to the appointment and remuneration of financial auditors). The disqualifications mentioned in Section 226 also apply to Cost Auditors. The Cost Auditors have the same powers and duties as are provided to company’s auditor under Section 277(1).

4.4 Disqualifications of Cost Auditor

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 cost accounts. [Sec. 233 (B)(5a)]

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 a company. As regards to above section, following are some disqualifications of appointment of cost auditor:

(1) An employee of the company cannot be appointed as an auditor.

(2) Any person who has been appointed as a financial auditor cannot be appointed as a cost auditor.

(3) A company cannot be appointed as a cost auditor.
(4) A person who is indebted for the company for Rs. 1,000 cannot be appointed as a cost auditor.

4.5 Penalties for defaults by the Company/Cost Auditor

If a company makes default in complying with the provisions of section 233B of the Companies Act, the company is liable to be punished with fine which may extend to five thousand rupees and every officer of the company who is in default is liable to be punished with imprisonment for a term which may extend to three years, or with fine which may extend to fifty thousand rupees or with both. The offence is compoundable under Section 621A. [vide 233B (11)]

4.6 Cost Audit Report

The cost Auditor makes his report (triplicate) in the prescribed form to the Central Government within such time from the end of the financial year (presently it is 180 days) and copy of the said report is forwarded to the company in the prescribed period. To enable the cost auditor to discharge his functions, the company is obliged to give all facilities and assistance to the cost auditor. In this regard, the company and its officers are required to make available to the cost auditor, within 90 days from the end of the financial years, the cost accounting records, cost statements and other books of account. If these documents are not made available within the prescribed period, the cost auditor should inform the Central Government within 10 days of the aforesaid time limit of 90 days [Refer Rule 6 of the Cost Audit (Report) Rules, 1996].

4.7 Action on the Cost Audit Report

The company within 30 days from the date of receipt of the cost audit report is required to furnish full information and explanations on
every reservation or qualification, if any, contained in the audit report to the Central Government. The cost auditor shall also give clarifications, if any, required by the Central Government on his report within 30 days.

The Central Government on receipt of report and/or explanations etc., may take such action as it may deem necessary. It may also direct the company to circulate the report in whole or in part to its members along with the notice of the annual general meeting.

The Cost Audit (Report) Rules, 2001 [w.e.f. 1-10-2002]

The Central Government has framed "The Cost Audit (Report) Rules, 2001 [in supersession of the Cost Audit (Report) Rules, 1996] as to audit of cost accounts. In the Cost Audit Report, the cost auditor has to state whether he has examined the books of account maintained under clause (d) of sub-section (1) of section 209 of the Companies Act and other relevant records. The Cost Auditor has also to report on certain matters, viz.

1. Whether he has obtained all information and explanations necessary for the purpose of audit.

2. Whether proper cost accounting records as required under section 209 (1) (d) have been kept by the company.

3. Whether proper returns adequate for the purpose of cost audit have been received from branches not visited by him.

4. Whether the books and records give the information required by the Companies Act, 1956 in the manner required.

5. Whether the company's cost accounting records have been properly kept so as to give a true and fair view of the cost of production,
processing, manufacturing or mining activities and marketing of the product.

6. Whether the cost statement as specified in the Annexure/Proforma of Schedules I to III as applicable of Cost Accounting (Records) Rules duly audited by him are kept in the company. The salient features of the Cost Audit (Report) Rules, 2001 are given below:

1. The Cost Audit Report is required to be submitted to the Central Government, in the prescribed form, with a copy thereof to the company which is subject to Cost Audit, within one hundred eighty days from the end of the company's financial year to which the Cost Audit Report relates.

2. The clarifications, if any, required by the Central Government on the Cost Audit Report shall be furnished by the Cost Auditor within thirty days of the receipt of the communication in that regard.

3. The concerned company shall make available the cost accounting records to the Cost Auditor within one hundred and thirty-five days from the end of the financial year of the company.

4. In case of failure of Cost Auditor to submit his report within 180 days and/or to furnish the clarification(s) sought by the Central Government within 30 days of the receipt of the communication in that behalf, he shall be liable for fine which may extend to five thousand rupees.

If the company fails to furnish the cost accounting records to the cost auditor within 135 days from the end of the financial year of the company, the company and every officer of the company [including person referred to in sub-section (6) of section 209 of the Act] who is in default shall; subject to the provisions of section 233B, be punishable
with fine which may extend to five thousand rupees and when the contravention is continuing with further fine upto five hundred rupees for each day of default.

5. The cost audit report is required to be accompanied by an Annexure thereto containing the information and data as prescribed.

4.8 COST AUDIT REPORT

I/We................... having been appointed as auditor(s) under Section 233B of the Companies Act, 1956 (1 to 1956) hereinafter referred to as that Cost Auditor(s)' of Messrs.................. Ltd. (hereinafter referred to as the company), have examined the books of accounts prescribed under clause (d) of sub-Section (1) of Section 209 of the said Act and other relevant records for the year ended.............relating to............maintained by the company and report that:

(a) I/We have obtained all the information and explanations which to the best of my/our knowledge and belief were necessary for the purposes of this audit;

(b) proper cost accounting records as required under clause (d) of sub-Section (1) of Section 209 of the Companies Act, 1956 (1 of 1956) have been kept by the company;

(c) proper returns adequate for the purpose of my/our cost audit have been received from branches not visited by me/us;

(d) the said books and records give the information required by the Companies Act, 1956 (1 of 1956) in the manner so required; and
(e) in my/our opinion the company’s cost accounting records have been properly kept so as to give a true and fair view of the cost of production, processing, manufacturing or mining activities, as the case may be, and marketing of the product under reference.

The matters contained in the Annexure to this report form part of this report which is also subject to my/our observations made therein. Dates this.....day of.....20.......at......@Cost Auditors(s).

4.9 ANNEXURE TO THE COST AUDIT REPORT

1. General

(1) Name and address of the registered office of the company whose accounts are audited.

(2) Name and address of the Cost Auditor.

(3) Reference No. and date of Government Order under which the audit is conducted.

(4) Date of the general meeting of the company in which the auditor under Section 233 B has been appointed.

(5) The company’s financial year for which the audit report is rendered.

(6) Date of incorporation of the company, and its ‘status’ (i.e., whether it is a public company/private company / private company which is a subsidiary of a public company etc.)

(7) Location where accounts are maintained.

(8) Location of Factory/Factories.
(9) If there is any foreign technical collaboration for the product under reference, attach a copy of the collaboration agreement. If this is not possible, prepare a brief note indicating:

(a) Name and address of the foreign collaborators.
(b) Main terms of agreement.
(c) Amount of Royalty/Technical aid fee payable and the basis of calculating the same.
(d) Whether the technical collaborator has contributed to the share capital. If so, the paid-up values of shares so held.

(10) Licensed, installed and utilized capacities of the Factory/Factories for the product under reference.

(11) Date of first commencement of commercial production of the product under reference (If more than one factory under the same company produces the product under reference, particulars in respect of each may be given).

(12) If the company is engaged in other activities besides of the other activities.

2. Cost Accounting System

Briefly comment on the Cost Accounting system and its adequacy or otherwise to determine correctly the cost of the product under reference.

3. Financial Position: Relating of the product under the reference if possible otherwise company as a whole.
(1) Capital employed- Capital employed—defined as total assets at book values (excluding investments outside the business) minus current liabilities.

(2) Net worth- Net worth, i.e., Capital plus Reserves or Capital less losses, as the case may be. If there is any change in the composition of the net worth during the year, special mention may be made.

(3) Profit before tax- Profit after providing for depreciation both other expenditure except interest on borrowings and debentures but before providing for taxes on income.

(4) (i) Expenses to be specified- the Amounts in respect of the following:

(a) Annual bonus to employees.

(b) Interest on borrowings and debentures etc.

(c) Bad debts.

(d) Donations of all kinds.

(e) Retrenchment or other compensation to employees excluding premium on account of workmen's compensation insurance.

(f) Lay-off wages.

(g) Expenditure on special exhibitions etc., other than normal trade advertisements.

(h) Commission based on profit to Managerial personnel.

(i) Income-tax and Surtax.

(j) Any other item of expenditure the incidence of which is neither normal nor of a recurring nature.

(ii) Income to be specified
(a) Interest received on investments outside the business.

(b) Capital gains.

(c) Any other income which is neither normal nor of a recurring nature.

(5) Ratios

(a) Profit arrived at as per 3(3) above expressed as a percentage of:
   (i) Capital employed as per 3(1) above
   (ii) Net sales.

(b) (i) Current assets expressed as a percentage of current liabilities.
   (ii) Net worth expressed as a percentage of long-term borrowings and liabilities.
   (iii) Net worth expressed as a percentage of capital employed as per 3(1) above.

(c) Cost of Production as a percentage of:
   (i) Capital employed as per 3(1) above.
   (ii) Working capital (i.e., current assets less current liabilities).

4. Production

This information is to be given for each type of product under reference.

(1) Production in quantities.

(2) Indicate percentage of production of the product under reference in relation to the installed capacity. If there is any
shortfall in production as compared to the installed capacity, comment briefly as to the reasons for the shortfall.

(3) If there is any addition to the production during the year under review or in the immediately preceding two years this may also be mentioned.

5. Process of Manufacture

A brief note regarding the process of manufacture of the product under reference may be given.

6. Raw Materials

(1) Show the cost of major raw materials consumed both in terms of quantity and value. Where the cost of transport etc. of raw materials is significant, specify the same separately.

(2) (a) Consumption of major raw materials per unit of production compared with the standard requirement, if any.

(b) Explanations for variations if any, in the consumption of man or raw materials per unit of production as compared to the preceding two years.

(3) Briefly comment on the method of accounting followed for recording the quantities and value of receipts, issues and balances of all materials directly used in production.

7. Power and Fuel

Quantity, rate per unit and total cost separately for each major form of power and fuel used in production, e.g. coal, furnace oil, electricity etc. Compare the actual consumption per unit of production with standards, if any. Special features, if any, may also be indicated.
8. **Wages and Salaries**

(1) Total wages and salaries paid for all categories of employees, separately in respect of each of the following:

   (a) Direct labour costs on production.

   (b) Indirect employee costs on production.

   (c) Employee costs on administration.

   (d) Employee costs on selling and distribution.

   (e) Other employee costs if any (specifying purpose).

   (f) Total employee costs [total of items (a) to (e) above].

(2) Total man-days of direct labour available and actually worked for the year.

(3) Average number of workers employed for the year.

(4) Direct Labour cost per unit of output of the product under reference (if more than one type of product, give information in respect of each).

(5) Brief explanations for variations in (4) above, if any, as compared to the previous two years.

(6) Comments on the incentive schemes, if any, with particular reference to its contributions towards increasing productivity and its effect on the cost of production.

9. **Stores and Spare Parts**

(1) The expenditure per unit of output on stores etc.

(2) Discuss the system of stores accounting for recording receipts, issues and balances, both in quantities and values.
(3) Indicate, if practicable, the proportion of closing inventory of stores representing items which have not moved for over 24 months.

10. Depreciation

(1) State the method of depreciation adopted by the company, e.g. straight line or diminishing balance etc. State whether the depreciation provided by the company is more or less than the amount of depreciation worked out in accordance with provisions of sub-Section (2) of Section 205 of the Companies Act, 1956.

(2) State the basis of allocation of depreciation of common assets to the different departments.

(3) Indicate the basis of charging depreciation to the cost of products.

11. Overheads

(1) Give separately the total amounts of the following overheads and a break-up of items (a), (b) and (c) below.

(a) Factory overheads.

(b) Administration overheads.

(c) Selling and distribution overheads.

(d) Interest.

(e) Bonus to employees.

(f) Commission to Managerial personnel.

State whether any amounts in respect of items (d), (e) or (1) have been included, in the total amounts of items (a), (b) or (c) and give the amounts so included, if any.
(2) Indicate reasons for any significant variations in the expenditure incurred against the items included in overheads as compared with the previous two years.

(3) State the basis of allocation of overheads to cost centers and of absorption to products. Give brief comments, if any, on the basis of allocating adopted by the company.

(4) Cost of packing, if any, of the products under reference to be shown separately with details to the extent possible.

12. Royalty/Technical Aid Payments

State the total amount of Royalty/Technical Aid Fees payable for the year and the amount chargeable per unit of the product.

13. Sales

(1) Indicate the sales in quantities and net sales realisation of the products under reference showing the average sales realisation per unit. (If more than one type of product is sold, information to be given in respect of each).

(2) If the product under reference is exported, indicate quantity exported, net realisation per unit, countries to which exported—details may be given, indicate the profit/loss incurred in exports.

14. Abnormal Non-Recurring Costs

If there were any abnormal features affecting production during the year, e.g. strikes, lockouts, major breakdowns in the plant, substantial power cuts, serious accidents etc., they shall, wherever practicable, briefly mentioned indicating their effect on the cost of production.
15. Other Items

It there are any special expenses which have been directly allocated to products under reference the total amount as also the unit incidence shall be shown.

16. Auditor’s Observations and Conclusions

(i) The cost auditor may here report on:

(a) matters which appear to him to be clearly wrong in principle or apparently unjustifiable;

(b) Cases where the company’s funds have been used in a negligent or inefficient manner;

(c) Factors which could have been controlled, but have not been done resulting in increase in the cost of production;

(d) Contracts or agreements, if any, between the company and other parties relating to selling, purchasing etc.

(e) (i) the adequacy or otherwise of budgetary control system, if any, in vogue in the company;

(ii) the scope and performance of internal audit, if any.

(f) Suggestions for improvements in performance, if any, e.g., by—

(1) Rectification of general imbalance in production facilities;

(2) fuller utilisation of installed capacity;

(3) Concentration on areas offering scope for—

(i) Cost reduction

(ii) Increased productivity
(iii) Key limiting factors causing production 'bottlenecks'.

(4) Improved inventory policies.

The opinions expressed shall be based on verified data, reference to which shall be made here and shall, wherever practicable, be included after the company has been afforded an opportunity to comment on them.

(ii) Copies of the cost statements in respect of completed products as given in Schedule II of the relevant notification issued under clause (d) of subsection (I) of Section 209 of the Companies Act, 1956 duly completed and audited shall be appended to the report.

(iii) If as a result of the examination of the books of account, the auditor desires to give a qualified report, he shall indicate the extent to which he has to qualify the report and the reasons therefore.

(iv) A statement showing the reconciliation of the profit or loss as indicated under 3(3) above with the profit or loss relating to the product under reference as arrived at on the basis of the cost statements annexed to the report and the net sales realization as indicated in 13(1) above shall be appended to the report.

(v) After the auditor appointed under Section 224 of the Companies Act, 1956 (1 of 1956) submits his report, the cost auditor may, if he considers it necessary, submit a supplementary report to the Central Government before the date fixed for holding the annual general meeting of the Company. The supplementary reports shall be limited to the extent of reconciling the statements annexed to the cost audit report with the financial accounts of the Company.
Notes: (1) Figures to be given for the year under audit and to the extent practicable, for the two preceding years.

(2) If the company has more than one factory producing the product under reference, details indicated in the annexure may be given separately for each factory, if such details are available.

(3) If different varieties/types of products under reference are manufactured by the company, details of cost in respect of each shall be given.

(4) The matters contained in the annexure shall be duly authenticated by the cost auditor.