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Conclusion and Suggestions
CONCLUSION AND SUGGESTIONS

Conclusion:

The Indian economy is passing through the critical phase of reforms, wherein the administered pricing mechanisms are being dismantled in most of the places and the regulatory authority mechanism is taking its place. Liberalization does not eliminate the need to regulate prices and profits to bring about economic balance. The regulatory authority mechanism is considered more transparent and efficient.

In many countries, policy makers and financial administrators struggle to develop an appropriate regulatory framework with the objective to stimulate innovations and market penetration on the one side and ensure sound business practices or good corporate governance on the other side.

Further regulatory mechanism should be applied in a manner, which would usher in investment and efficiency. Regulation itself is imperfect when the right regulatory mechanisms are not clearly defined. It is all the more imperfect when it is implemented without an adequate information base and sophistication.

These regulatory authorities, therefore, need proper and professional Information Management Systems, which are designed to dispense usable data in an efficient manner. This involves integration of heterogeneous information. CARR 2001 is the ‘Just and Perfect’ solution promulgated by the Regulatory Authorities.
It is apparent that the users of financial reports (CIL) interviewed do not have much coal mines in the cost audit, as they do not consider mandatory cost audit to have any role in their investment decisions that is, risk-taking in relationship. It is interesting to note the differences in opinion between cost auditors in practice and the users of financial statements. In contrast to the opinions of the latter, all of the cost auditors interviewed suggested that a mandatory cost audit enhances mines of various user groups of financial statements. It could be argued that cost auditors have an interest in promoting mandatory cost audits. It has also been observed that the opinions of the preparers of financial reports are similar to those of the users of these reports. They also stated that a mandatory cost audit does not increase the better settlement of existing and prospective investors on financial statement numbers.

Hence, there lies a doubt concerning whether the mandatory cost audit is fulfilling its purpose in the Indian context. All of the high-level officials of the companies and sophisticated investors suggested that the mandatory cost audit function is wasteful of money and resources in this era where competition is vital between business organizations, which can take care of the perceived operational efficiency expected to be gained through cost audit compliance.

The investors interviewed do not perceive cost auditors to possess additional ability, compared to auditors, in performing the audits of financial statements. Mandatory cost audit has not been perceived to provide any value-based service as business organisations try to improve their operational efficiency in order to provide better quality goods at
reasonable price so that they can compete at the market place. Similarly, the ability of cost auditors to provide more accurate data concerning closing stock, work-in-progress and hence profit has also been questioned by those investors interviewed as they perceive that the financial audit also does the same function. From this perspective, imposing a cost audit is a duplication of the same job. The same opinion has been expressed by the preparers of financial reports interviewed. These preparers of financial reports do not believe that a cost audit has better ability to detect fraud and misrepresentation as well.

The benefit of the mandatory cost audit has also been questioned by some preparers of financial reports and investors as the cost audit report is not disclosed to the public and does not form a part of the annual report. The integrity of the mandatory cost audit has been doubted by one of the preparers of financial statements. Most of the respondents perceived few, if any, specific benefits arising from the cost audit process, and suggested that the main benefit of the implementation of mandatory cost audit in India has been to cost accountants, especially those engaged in auditing.

SUGGESTIONS

Suggestions on Cost Accounting System

The Company should have Cost Accounting Manual. This will facilitate preparing write-up on Cost accounting system and various areas to be covered therein are as under:

1. Narration of cost accounting system should be brief, to the point and unambiguous. It should cover all points as required by the relevant Cost
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Accounting Records Rules and requirements of the Cost Audit Report Rules also.

For example, Cost Audit Report Rules require separate proforma (product-wise cost-sheet) to be appended to the Cost Audit Report for related party! Inter unit transfer of the intermediate! finished product(s) under reference, It may not be specified in the concerned Cost Accounting Records Rules applicable to the company, still the company is required to keep such data as a part of its cost accounting system.

2. The word "correctly" used in Para 2 (1) is to be treated as synonymous with the phrase "true and fair view" used in the main certificate. Since cost ascertainment involves various bases in apportionment of common costs and in evaluating inputs, "true and fair view" is a better expression than "correct".

3. While interpreting, the phrase "Cost of Production" it must be taken to mean "Cost of Production, processing, manufacturing’ mining and services”. This becomes relevant as some of the prescribed Cost Accounting Record Rules apply to mining; processing activities, service sector industry etc.

4. For illustration, Cost Accounting Records (Textiles) Rules apply to every company engaged in the “Production, processing or manufacturing” of textiles. Hence even textile processing companies, who process textiles produced by other manufactures, are covered by those Records Rules. Similarly in case of cement and Aluminum industries the mining of limestone and bauxite are covered by the relevant cost accounting records rules. On the same lines, Cost Accounting
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Records Rules for Electricity Industry are prescribed, where the concept of cost of services in place of cost of production will be relevant.

5. In case of Annexure to the Cost Audit Report, the cost auditor is required to endorse the cost accounting system, its adequacy or otherwise and the changes made during the year under audit over previous year as mentioned in this para by the company. This para becomes starting point for his professional / expert comments on following items, which have bearing on cost accounting system, in his main report:

1. Proper cost accounting records, as prescribed under clause (d) of sub-section (1) of section 209 of the Companies Act, 1956, have/have not been kept by the company.

2. The company’s cost accounting records have/have not been properly kept so as to give a true and fair view of the cost of production, cost of sales and margin of the product under reference as prescribed under the rules;

3. The adequacy or otherwise of the cost accounting system including inventory valuation in vogue in the company and suggestions for the improvement thereof. The Cost auditor shall also indicate the persistent deficiencies in the system, pointed out in earlier reports but not rectified.

4. Matters which appear to him to be clearly wrong in principle or apparently unjustifiable.

5. Any other observations and suggestions, if any, relevant to the cost audit. To have better judgment to form opinion, the Cost Auditor is advised to review the cost accounting system with reference to the
requirements of relevant Cost Accounting Records Rules. The Schedule annexed to Cost Accounting Records Rules enlists details of records to be maintained.

The above should be used to obtain first hand knowledge of:

(a) Other activities besides manufacture of product under review.

(b) Interaction between activities under review and those not under reviews.

(c) Fairness of allocation of costs between activities under review and those out of review.

(d) Identification of scrap, analysis of scrap, its quantification and disposal, including recycling or reuse of scrap.

(e) Effectiveness of accounting system in force in regard to scrap, spoilage, wastage.

(f) Physical verification of work-in-process, finished goods etc.

(g) Areas offering scope for profit improvement or cost reduction.

Presentation of data:

In certain cases direct materials may have to be grouped into certain classes. The attempt should be to strike a balance between providing mass of data, which could be too voluminous to be indicative and providing data in a sketchy manner. For example in Engineering industries, where a number of types of steel are used, it may be advisable to group them together under one class- steel. A helpful guideline could be to list out all materials-or class of materials- which individually constitutes, more than 2% of the total material cost.
Overheads:

1. Overheads are a well defined term in Costing terminology. Classification of such overheads into factory, administration, selling and distribution is to be based on functional responsibilities.

2. The break up of functional overheads is required to be given under various heads (items) complying with the condition of "at least 80%" of the total overheads cost under each head. Other heads/Items may be grouped under one group may be termed as "others".

However, it is advisable to furnish as many heads as "practical" so that comparison over a period is more meaningful. The information also becomes more explanatory and useful.

Quality control:

Quality control may actually relate to various functions and activities such as inspection of incoming material, inspection during the progressive stages of manufacture of the product, inspection on completion of the finished product etc. The company may establish cost centers suitable to its design of the costing system. If quality control activity is distinctly segregated by forming different cost centers, it may get reflected under the corresponding functional overheads such as materials related overheads. The quality control expenses relating to production may be presented as a separate cost head in the costing proforma, however if it is not so, the entire expenditure on quality control may be presented as a separate cost head in the costing proforma.
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Abnormal Non Recurring Costs:

The figures should be following characteristics:

a) The cost should be “abnormal” and

b) The abnormal cost should be none recurring.

In other words, if the cost is abnormal but if it is of recurring nature, it need not be shown under this para. This may be because the continuous occurrence of an event making it recurring makes the abnormal cost look like a normal cost not attracting mentioning thereof under this para.

Role of Auditor

1. Should review the causes explained by the company for non—movement of the items

2. Should review how the company deals with the non moving stocks.


4. Should carefully examine the policy of the company regarding determination of non-moving items.

Written off Stock:

1. Write-off - to transfer the balance of an account previously regarded as an asset to an expense account or the profit and loss.

2. Valuation of Inventories (Revised) As —2

Reference should be made AS—2 and in particular to the following clauses:
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2a. The cost of inventories may not be recoverable if those inventories are damaged, if they have become obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs necessary to make the sale have increased. The practice of writing down inventories below cost to net realizable value is consistent with the view that assets should not be carried in excess of amounts expected to be realized from their sale or use.

2b. Inventories are usually written down to net realizable value on an item-by-item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses and are produced and marketed in the same geographical area and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write down inventories based on a classification of inventory, for example, finished goods, or all the inventories in a particular business segment.

2c. Estimates of net realizable value are based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realize. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the balance sheet date to the extent that such events confirm the conditions existing at the balance sheet date.

2d. Estimates of net realizable value also take into consideration the purpose for which the inventory is held. For example, the net realizable
value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realizable value of the excess inventory is based on general selling prices. Contingent losses on firm sales contracts in excess of inventory quantities held and contingent losses on firm purchase contracts are dealt with in accordance with the principles enunciated in Accounting Standard (AS) 4, Contingencies and Events Occurring after the Balance Sheet Date.

2e. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.

2f. An assessment is made of net realizable value as at each balance sheet date.

Collection and compilation of data:

1. The information should be compiled at item level for all items.

2. The procedure and authorization for approval to adjust excess! Shortage should be disclosed by the company.

3. The corrective measures taken by the company such as, internal enquiry held improvement in present procedures and checks to avoid
future variations should be disclosed by the company. Auditor should comment on the adequacy of the steps taken.

**Competitive Margin against Imports:**

**a.** In the post liberalization era, Dumping of goods is a new threat to industrial growth and prosperity of all the countries. Many Indian industries have suffered the impact of Dumping of Goods in Indian market indulged in by exporters in other countries. In some cases, the prices were so low that they were less than the material cost of Indian manufacturers.

**b.** At this stage, Indian industry became consciously aware that like all other countries, India also has its own Anti Dumping Act. This Act has been on the Statute book for a number of years, but it was seldom used, if at all. However, after the WTO impact, a large number of Indian industries are taking recourse to the provisions of this Act and are safeguarding them from the menace of Dumping. By making applications to Designated Authority, action against the offending exporters to India is initiated and Duties are imposed on exports to India from offending countries in certain cases.

**c.** It must be mentioned that the information to be furnished by complainants under Indian Anti Dumping Act is to be certified by Cost Accountant.

**d.** Contents of this paragraph will be immensely useful for evaluating competitiveness of the enterprise in the Post Uruguay period, i.e., in the WTO era. Title of this paragraph speaks only of competitive margin.
against imports. However, the data contained in the table will also help us evaluate our industries’ competitiveness to improve export performance.

e. When it comes to facing Anti Dumping and Anti Subsidy proceedings initiated by other countries against Indian industries (exporters), it has been the experience that a major hurdle encountered by Indian industry is inadequacy or total lack of requisite, authenticated (certified) information on operational performance.

f. The information to be submitted under paragraph 22 of CARR 2001 will overcome the hurdle mentioned above and thus equip Indian industries and their Associations to successfully negotiate the on-lash of WTD era by converting threat into opportunity.

g. Thus, Industry will benefit from this, in following ways:

A] Judgment on own performance against Global prices;

B] Prepare it well to face Safeguard, Anti Dumping and Anti Subsidy proceedings that may be initiated by other countries;

C] Protect itself from threat of Dumping by other countries;

D] Convince Government of India of Industry’s viewpoint for initiating Protective measures under WTO with reliable data and authenticated cost figures;

E] Information being readily available on hand, time delay in initiating actions can be avoided;

F] And most important, Information as gathered from this Paragraph will help-
(i) Government of India in proper preparations for green room and ministerial negotiation proceedings.

(ii) It will help in formulation of Government policy with respect to the industries to ensure proper growth and prosperity of industry.

G] This can be done by improving export performance by facilitator role of Government policies and at the same time combating the dumping menace while remaining within the WTO framework.

H] Information to be furnished in this paragraph relates to product under reference.

Every Company covered under Cost Accounting Record Rules, even if an Audit of Cost Accounts has not been ordered by the Government, should take steps to collect, compile and be prepared to present the information required under this paragraph.

I] Even if the Company has neither imported nor exported any quantity of product under Cost Audit during the year / period under Audit, it shall report other information under this paragraph.

J].Information to be given against the following items is external to the Company’s operations -

No.2: Estimated demand of the product in the country

No.3: Total production in the country

No.4: Quantities imported in the country

No.11: FOB value of quantity imported in the country
No.12: Weighted average FOB rate of quantities imported in the country (item 11 / item 4)

No.14: Major exporting countries (other than those listed in item 4 above)

No.16: Bound rate of duty under WTO agreement.

i. Such external information will have to be obtained from external sources such as journal / statistical data / books published by industry Associations, Export Promotion Councils, publication of Customs Department — Customs Bulletin, information made available by research institutions in the country, reports published by trade and other departments of Government of India as also Governments of other nations trading the products under reference, etc.

ii. For every such external information given in the table, the source from where the information has been obtained is to be clearly mentioned as a footnote. This will help Government while reviewing the relevant information received from various companies dealing in the products under reference across the industrial spectrum.

K] The information to be furnished against following items of paragraph 22 is to be furnished each country-wise, so that at least 80% of the total is available country-wise. The balancing figure may then be shown as a single entry under the head ‘other countries’.
While deciding the 80% coverage, consideration should be given to the Quantity as also to the Value. In other words, the country-wise details given should cover 80% of the Quantity and 80% of Value too.

No.4: Quantities imported in the country
No.8: Quantity of the product imported by the company
No.9: FOB value of quantity imported by the company
No.10: Weighted average FOB rate for quantities imported by the company (item 9 / item 8)
No.11: FOB value of quantity imported in the country
No.12: Weighted average FOB rate of quantities imported in the country (item 11 / item 4)
No.13: Competitive margin [(item 12 less item 7(A)]

Un-audited figures of the previous year:

Un-audited figures of the previous year: If the previous year’s figures are not audited by the Cost Auditor, he should clarify the position by means of a note that ‘figures so stated are on the basis of information furnished by the management, for which he has obtained a certificate from the management’. This note should be given under Cost Audit Report — Para 5.

The Statement on Standard Auditing Practices (SAP-i 1) “Representations by Management”, issued by the Council of the Institute of Chartered Accountants of India is having the purpose to establish standards on the use of management representations as audit evidence,
the procedures to be applied in evaluating and documenting management representations, and the actions to be taken if management refuses to provide appropriate representations. It further prescribes that the auditor should obtain evidence that management acknowledges its responsibility for the appropriate preparation and presentation of financial information and that management has approved the financial information.

Need for such practice in Cost Audit:

The Cost Audit is also a statutory audit under the Companies Act 1956 and the ICWAI members carrying out Cost Audit are having same powers and duties as prescribed for financial auditor u/s 227(1) of the said Act. During the course of Cost Audit the Cost Auditor is also expected to follow certain methodology as to Audit Evidence, Working Papers, Audit Planning, Materiality Concept, Analytical Procedure, Going Concern Assumption, Subsequent Events, and Knowledge of Business etc. As such, it is felt appropriate to suggest such methodology for Cost Audit also.

The auditor should exercise his professional judgment in determining the matters on which he wishes to obtain representations from management either orally or in writing depending upon the materiality concept. Representations by management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. For example, representation by management as to the allocation and apportionment of expenses is no substitute for adopting normal audit procedures regarding verification of bases followed for such allocation and apportionment.
In certain instances such as where knowledge of the facts is confined to management or where the matter is principally one of intention, a representation by management may be the only audit evidence which can reasonably be expected to be available; for example, intention of management to hold a specific investment for long term appreciation.

If other evidence contradicts a representation by management, the auditor should examine the circumstances and, when necessary, reconsider the reliability of other representations made by management.

The auditor should obtain either a letter from the management or duly authenticated copy of relevant minutes of meetings of the Board of Directors or similar body and maintain such documents as evidence of management's representations. If management refuses to provide such letter, then the auditor may himself prepare suitable letter mentioning the auditor understands of management’s representations and get it duly acknowledged and confirmed by management. If the management refuses to acknowledge or confirm the letter sent by the auditor, this will constitute a limitation on the scope of his examination. In such circumstances, the auditor should evaluate any reliance on those representations and consider if the refusal may have any additional effect on his report.

Considering the above, it can be suggested that the mandatory cost audit in India has not enhanced the level of mines of investors in financial statements. It seems to have had little or no impact in minimising the perceived risks of investors with respect to financial statement numbers,
and the process of cost audit does not impact their choice of investment decision.

Finally, it can be suggested, following our findings, that future research should carefully consider the usefulness and the cost and benefit aspects of the mandatory cost audit. The extent to which the financial audit enhances the users' trust in financial statements, which is outside the scope of the present research work, should also be considered in this regard.