CHAPTER - I
CHAPTER-I

INTRODUCTION

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1.1 Significance and Need of the Study

Cost audit now a superfluous tool for scrutinizing business practices. According to recent reports, the government has an open mind on this question, but has placed under review the present practice of mandatory (government-imposed) cost audit.

"A systematic examination of the activities and status of an entity based primarily on investigation and analysis of its system, control and records".

With the growth and development of cost accounting system, it became necessary to maintain cost records and cost books to record. It is necessary that either in financial accounting or in cost accounting system, wherever books and records are kept, they must be examined independently to ensure that they have been kept and recorded fairly and correctly and that there are no errors of omission and commission and there are no defalcation. So once the cost accounts are prepared, they should be audited in all fairness. It should be done either by the internal staff of the company to the satisfaction of management or under statutory audit, by the Government approved auditors in case of companies in India to which section 209(i)(d) and section 233(B) of the companies act apply.

The companies (Amendment) Act, 1965 empowers the government of India to enforce through the cost audit record rules prescribed under the companies Act-44 products (rather, sectors) have so far been notified as requiring compulsory cost audit.

Virtually, all major industries- coal industries, petroleum, chemicals, and textiles. Engineering, cement, paper, electricity, steel, etc
are covered of course in term of their ‘products’. The only service industry that has to obligatorily include cost audit statements in financial reposts is telecom.

**Cost Audit Practice in India**

The cost audit was first recommended to Indian industries by Vivian Bose enquiry commission. So the government thought it that cost audit is necessary for optimum utilization of resources by Indian industries. Section 223-B of the companies Act of 1956 provides for ordering of cost audit by Government. The Cost Audit (Report) Rules 1968 laid down by the Government of India makes certain industries to get cost books compulsorily audited.

The review, according to a corporate affairs ministry official, would be a 'broader' one, meaning, the rationality of government imposing cost audit would be verified afresh, keeping in mind the current realities of doing business: the scenario of market forces largely having a free run and corporate voluntarily being vigilant enough about being financially prudent.

However, hastened to add that no conclusive view would be taken, before the stakeholders, the industry, the community of cost accountants and regulators were consulted. After all, in case of products whose prices are controlled by the government, there might still be a need for the government assessing the cost to fix the profits.

In fact, a parliamentary committee on subordinate legislation, attached to the finance ministry, had in December 2004 called for enlarging the scope of mandatory cost audit by bringing "essential
services”, health, education, civic amenities, basic infrastructure (road, water, etc.), under its purview. The panel’s rationale was that with subsidies being knocked off, these sectors increasingly move towards free pricing, necessitating closer scrutiny of cost. The committee later pulled up the ministry for not acting fast enough on this score, and this seems to have jolted the government into action. So the official version is that the proposed review would be without any prejudice and so might not necessarily result in a reduction in the scope of cost audit. But the undertones suggest otherwise.

At present, under Section 209 1D of the Companies Act, cost auditing is mandatory on certain classes of companies. In a recent communication to the parliamentary committee, the corporate affairs ministry defined the relevant criteria thus: companies making products that involve subsidies or whose prices are administered, companies engaged in production of defense equipment, companies in industries consisting of public sector enterprises and companies in regulated industries.

This is but a very broad (almost all-encompassing) and rather vague criteria. Which means the government is not quite sure of where to apply Section 209 1D. In actual practice, cost audit is enforced through the cost audit record rules prescribed under the Companies Act—44 products (rather, sectors) have so far been notified as requiring compulsory cost audit.

Virtually, all major industries—petroleum, chemicals, textiles, engineering, cement, paper, electricity, steel, mining etc, are covered, of course, in terms of their “products” (goods). The only service industry that has to obligatorily include cost audit statements in its financial
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- The only permanent change in the changing world is change itself. Dr. JJ Irani committee formed in December, 2004 to provide useful inputs for the revision of the Companies Act, has given in its report enough pointers on the maintenance of Cost Accounting Records and the conduct of Audit thereof which will necessitate re-visit of areas covered under records rules and revision of Cost Audit provisions. While on the face of it the committee has accepted that the provisions relating to Cost Audit and Records Rules were important instruments that would enable companies make their operations efficient and exist in a competitive environment has also pointed out that :

(a) It would be relevant for the Government or the regulators concerned with non-competitive situations to seek costing data;

(b) legislative guidance has to take into account the role of management in addressing cost management issues in context of the liberalized business and economic environment; and

(c) Government approval for appointment of Cost Auditor for carrying out such Cost Audit was also not considered necessary.

1.2 Importance of Study

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that involve subsidies or whose prices are administered, companies engaged in production of defense equipment, companies in industries consisting of public sector enterprises and companies in regulated industries. This is but a very broad (almost all-encompassing) and rather vague criteria. Which means the government is not quite sure of where to apply Section 209 1-D. In actual practice, cost audit is enforced through the cost audit record rules prescribed under the Companies Act—44 products (rather, sectors) have so far been notified as requiring compulsory cost audit.

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It would be relevant for the Government or the regulators concerned with non-competitive situations to seek costing data is relevant because in most parts of the world, free competition co-exists with relevant rules and regulations to ensure free trade and absence of unfair practice. Policy makers endeavor 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. Regulation itself is imperfect when the right regulatory mechanisms are not clearly defined and put in place. These regulatory authorities, therefore, need proper cost based information systems, which are designed to dispense usable data in an
efficient manner. This is more so if one out of many products are under any regulatory mechanism or are supplied to any government department or agency on cost–plus basis or if grant/subsidy is received on such expenses from government or any tax benefit is available on any one specific unit located in say backward area out of many units of the company, there is a definite tendency of the industry to allocate or apportion maximum possible expenses on that product or unit.

The emerging business and economic environment and providing legislative guidance to the system of cost accounting and cost management maintenance of cost records and identification of the cost for each product/activities is not a new thing in any company or industry. These are required for formulating effective pricing policies, long term strategies, retain competitiveness in the market and avoid unfair play. The records also serve an essential base for meeting the requirements of various Government Revenue Authorities like Excise Department, Customs Department, and Income Tax and to defend Anti-dumping and other allegations under WTO.

The Cost Accounting Records Rules are sincere efforts to induce the companies and inculcate a system so that such records are maintained under Generally Accepted Accounting Principles in a systematic way and on a uniform basis among the various companies of an industry. Otherwise, the cost calculated by different organizations may not be comparable due to usage of difference methods, procedures and practices adopted by the various accountants. The uniform cost accounting principles have all the real advantages of a cost accounting system besides providing a very good tool in the form of Management
Information System. These also promote healthy competition and enable industries to face national and international challenges in the present era.

Subsequent to Department of Company Affairs notifying Accounting Records (coal Industry) in December 2001, Cost Audit Branch of the Ministry of Company Affairs issued orders dated 16th September 2005, directing audit of the cost accounts maintained at the company’s generating stations, from the financial year 2005-06 onwards. Cost Auditors for the year 2005-06 were appointed with the approval of Central Government for conduct of cost audit and have submitted the Cost Audit report in terms of the said orders and the Cost Audit (Report) Rules, 2001.

Cost Audit in these guidelines refers to the cost audit ordered under Section 233B of the Companies Act, 1956. Such audit, in addition to the features mentioned above, has the following additional features:

(a) Assessing compliance by the company with the cost accounting records rules, as applicable to the product under review.

(b) Study of the costing system to assess whether it is adequate for the cost ascertainment of the product under review.

(c) Evaluation of the operating and other efficiencies of the organisation under audit with special reference to the product under review.

The basic structure of the cost audit was laid down by the Cost Audit (Report) Rules, 1968, prescribed under the Companies Act, 1956. They have been superseded by the Cost Audit (Report) Rules, 1996 which were published vide GSR 511(E) dated 5.11.1996.

The Cost Audit (Report) Rules, 2001 referred to as Report Rules have come into force from 27.12.2001. However keeping in view the practical difficulties of the companies and cost auditors to comply with the rules, the application of the rules has been deferred. Any Cost Audit Report submitted on or after October, 2002, irrespective of the financial year of the company to which it relates, has to be prepared as per the Report Rules, 2001.

Since audit is the part of the Companies Act, 1956, a thorough and comprehensive knowledge of that Act, including various rules prescribed there under and the circulars issued by the Department of Company Affairs is essential for conducting an effective cost audit.

1.3 Scope of the Study

Cost audit covers two aspects

(a) Propriety audit

(b) Efficiency audit.

(a) Propriety audit:

Propriety audit is an audit of management/administrative action and plans having financial implications for the enterprise. It has been defined as audit of executive Acton and plans bearing on the finance and expenditure of the company. It judges the roundness of managerial decisions and suggests the means to avoid waste in expenditure. Through
propriety audit, cost auditor will be able to establish whether or not the expenditure incurred by the company has shown the best result. He would be in a position to suggest the alternative the best result the audit of public sector undertakings conducted by the comptrollers and auditor genera of India is more of a propriety audit than a financial audit.

(b) **Efficiency Audit:**

Efficiency audit is mainly concerned with evaluation of plans and their result so as to ensure that they have been carried out efficiently. It ensures the application of the basic economic principle that the resources flow into the most remunerative channels. It involves comparison of actual performance with planned result and a trough enquiry into the variances. The aim is to see that the capital invested in the business gives the optimum return and the available resources are allocated among different functions and departments in such manner so as to give optimum result. It also examines the opportunities of a more profitable investment of money in another area.

India is the world’s third largest consumer of energy from coal, consuming 204.8 m. tone (in 2004), which accounts for more than half of the country’s total commercial energy consumption. While coal is probably the most polluting source of energy, it is abundant (India has the fourth largest reserves of coal in the world) and relatively cheap, and it is considered easier and safer to transport than oil or gas. In India, coal is used for power generation and in steel and cement mills. While coal’s dominance as energy source in India has slowly been decreasing, it is expected to continue, still accounting for more than 40 percent of consumption in 2030.
The IEA estimates that 362 m. tone of India’s commercial energy will come from coal by then. The majority of India’s coal reserves are located away from the major energy consumption areas in the north and west—in the country’s eastern and central states (Madhya Pradesh, Bihar, Jharkhand, and West Bengal). Recently, India has had to start importing coal, as production has struggled to keep up with consumption. The domestic coal shortage is expected to persist for at least another four years, with India projected to spend $6 billion a year importing coal until 2015.

1.4 Objectives of the Study

The specific objectives of the study are:

(i) to analyze the verification of the basic cost Accounting records of Coal India Limited, with regard to the different elements of cost.

(ii) to detect errors and fraud, if any, in the cost accounting records.

(iii) to find out if the concern is making optimum use of the available resources in different lines of activity.

(iv) to check whether the cost accounting records were in consonance with the cost accounting procedures.

(v) to facilitate inter firm and intra firm comparison of cost and business performance.

(vi) Checking the reconciliation of costing profit or loss with the financial profit or loss.
(vii) Bringing out inefficiencies in the matter of utilization and procurement of materials, utilizations of and payment to labourers and incurrence of overheads and direct expenses.

1.5 Research Methodology

An assurance audit has been conducted in accordance with professional auditing standards using an audit methodology adapted to our public sector environment. A dynamic suite of tools and techniques has been used, enabling each audit program to be individually tailored for each agency's risk profile.

Two sets of CIL records (included subsidiaries company) have been used in the study. The items listed in the Coal India Limited and the internal control were measure internal auditing practices by means of the statement on internal control: guidance for directors of Coal India Limited subsidiaries companies. The population used in this study has been all the subsidiaries companies listed in the Coal India Limited. The study has been used both descriptive and inferential analysis.

Sample Selection

1. Sampling Design:

Quota sampling has been used for the records of coal production and records relating to labour, records of overhead, depreciation and work in progress. The sample has been equally divided in to Coal India Limited and subsidiaries companies. The instrument used for the surveys has been record.
2. Collection of Data:

Data has been collected for a period of five years starting from April 2004. The data thus collected have been subsequently arranged, processed, tabulated and analyzed according to the need of the study. Various analytical + statistical tools have been employed for the analysis and interpretation of the data. Score have been calculated by assigning weightage to the preferred three issues. In case of preferences, the first preference is assigned three weightage points, the second preference is assigned weightage of two points and the third preferences is assigned one weightage point and the final score is calculated as under:

The score of factor X=Number of respondents given first preference x 3 + Number of respondents given second preference x 2 + Number of respondents given third preference x 1.

Statistical techniques like percentages and rations besides charts + diagrams have also been applied for analysis and interpretation. In addition, descriptive analysis technique has been used to address the qualitative aspects of the study. For historical data, the period of cost audit rules (2004 to 2009) whereas for CIL and subsidiary it was five year (2004-2009) normally. We have tried to incorporate the latest data as far as possible.

1.6 Plan of the Study

The study has been divided in eight chapters. The first chapter is introductory dealing with objectives, importance and research methodology of the study. The second chapter presents a conceptual
framework of conceptual frame work of cost audit practice. The third chapter presents Cost audit plan and programme. Fourth chapter is devoted to Statutory Cost Audit in India. The fifth chapter analyses the various features of Cost Audit System of Coal India Limited. The sixth chapter analyses the Cost Audit (Report) Rules. The seventh chapter analyses and examines the views of Review of Literatures. The summary of findings along with research based Conclusion and suggestions have been presented in the last eighth chapter.

1.7 Limitations of the Study

It cannot be said that the study is devoid of any limitations. Many limitations came before us during the collection of information/data. The facts which lead to the limitations of study are:

i) During the collection of information, it was found that most of respondents especially housewives and employees were rather hesitant and ambivalent in providing the desired information and sometimes they tolerated to discuss in some cases.

ii) It may be pointed out that the study is based both on the secondary as well as primary data related to production of coal and data from ICWA. The secondary data presented in the study is published information and some of them records could not be pursued in ICWA New Delhi. As such in-depth analysis of some issues could not be made

iii) The primary data were collected through a sampled study. However, considering the time and resource constraints of the researcher
it was not possible to make an in-depth analysis of some of the issues on cost audit practice in India.

iv) In the beginning we decided to analyse the role of cost audit practice in India, but CIL it is not in cost audit rules, 2001, Thus Cost Audit is not mandatory For Coal India Limited.

However, the above mentioned limitations have hardly any significant effect on the quality of the present study.