

Tutorial Notes

Class: B.Com (Hons.) Semester III (CC-5)

Subject: Auditing and corporate Governance

Topic: Cost Audit Meaning, Objectives, Advantages, Disadvantages and
Difference between Cost Audit and Financial Audit

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Cost Audit

It is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company. In simple words the term cost audit means a systematic and accurate verification of the cost accounts and records and checking of adherence to the objectives of the cost accounting.

The **ICWAI** defines cost audit as “system of audit introduced by the government of India for the review, examination and appraisal of the cost accounting records and attendant information required to be maintained by specified industries”

From above definition of cost audit, it is clear that cost audit is a systematic examination of cost accounts to verify correctness of cost accounting records.

As per the **section 233 B of Company Law 1956**, there is the provision for cost audit. Under this section, cost audit is compulsory for all the public and govt. companies which are associated with the processing and production. If there aggregate value of net worth exceeds 5 crores or total sale exceeds 20 crores, the cost audit is must.

Objectives of Cost Audit

The following are some of the objectives for which cost audit is under taken:

- 1.** To establish the accuracy of costing data. This is done by verifying the arithmetical accuracy of cost accounting entries in the books of accounts.
- 2.** To ensure that cost accounting principles are governed by the management objectives and these are strictly adhered in preparing cost accounts.
- 3.** To ensure that cost accounts are correct and also to detect errors, frauds and wrong practice in the existing system.
- 4.** To check up the general working of the costing department of the organization and to make suggestions for improvement.

5. To help the management in taking correct decisions on certain important matters i.e. to determine the actual cost of production when the goods are ready.
6. To reduce the amount of detailed checking by the external auditor if effective internal cost audit system is in operation.

Advantages of Cost Audit

To The Management

1. Cost audit helps in detection of errors and frauds.
2. The management gets accurate and reliable data based on which they can make day-to-day decisions like price fixation.
3. It helps in cost control and cost reduction.
4. It facilitates the system of standard costing and budgetary control.
5. It helps the management in inter-unit / firm comparison.
6. It enables the management to identify loss making propositions.

To The Government

1. Cost audit ensures efficient functioning of the industry. This in turn, nurtures a healthy competition among the different companies and paves a path for fast progress.
2. It helps in identification of sick units and enables the Government to make relevant decisions.
3. It helps in fixing prices in the case of essential commodities and checking undue profiteering.
4. It enables to take decisions as to granting of subsidies, incentives and protection to various industries.
5. It helps to take decisions as to levies, duties and taxes.

To the Society

1. Cost audit enables the Government to fix prices of essential commodities. This safeguards the interests of the society.
2. Cost audit enables the Government to keep a check on undue profiteering by the manufacturers and avoids artificial price rise due to monopolistic tendencies.

To the Shareholders

1. Cost audit reveals whether any of the products of the company are making losses. Thus though the company making an overall profit, a loss making line may eat up the company's profits. This is brought to the notice of the shareholders and the management is forced to take remedial measures, thereby making optimum utilisation of resources.
2. Cost audit ensures that the shareholders get a fair return on their investments.

Disadvantages of Cost Audit

1. Holding a Cost Audit can be expensive. This is because a company will often bring in an independent auditor who are normally charging higher price.
2. A Cost Audit can be a long process which will likely involve more time. This extra time and effort can impact an employee's day to day routine work.
3. If a Cost Audit is carried out in order to find fraudulent activity it can take a long time by which time people stealing could have covered their tracks.
4. Cost Audits involve a large amount of estimation and so there is the possibility that figures will be incorrect and if record keeping from the company is not good to start with then inaccuracies will be arises.

Difference between Cost Audit and Financial Audit

The main differences between cost and financial audit are as below:

Cost Audit	Financial Audit
Where to use: Where Cost Accounting techniques are used such as Manufacturing organisations there cost Audit is needed.	Where Financial Accounts are prepared. It is applied there.
Object: The object of cost audit is to see how to reduce cost of output.	The object of financial audit is to see that books of account are accurate.
Variation of What: In cost Audit, total cost and per unit cost of output is shown or varified.	The Financial Audit lays stress that Financial Position is shown true and fair.
Related to: It is only related to per unit cost of output.	Financial Audit is related to total income and expenditure.
Laws: The Cost Audit is related to test working efficiency of the organisation.	Financial Audit is to see whether laws and formalities are carried on or not.

Who does it: This Audit can be done by external parties such as Government, customer Trade Associations, Tribunals etc.	The Financial Audit is done by owners of the organisation.
Valuation of closing stock: Here Cost Audit sees that the stock is not more than the required quantum.	It is the duty of Financial Auditor to see whether the proper valuation of the stock is done or not.
Report: Here the report is submitted to the Government/Owner/Company Law Board.	In this, Audit report is submitted to shareholders.
Scope: The Cost Audit is confined to Factory/Works.	The Financial Audit is confined to the office.
Interest: This Audit protects the interest of Government and Producers.	It protects the interest of shareholders.
Period: Its report not confined to any specific period but related to objectives.	It is generally after one year or related to some special time.
Appointment: The Cost Audit is appointed with the prior permission of the Central Government or by the Board of Directors.	The Financial Auditor is appointed in General meeting of the company.