

# Maximizing Governance Leveraging Cost Accounting and Reporting

16<sup>th</sup> July 2014

A presentation to

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*Hon'ble Union Minister (Finance,  
Defence & Corporate Affairs)*

*By*

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# AGENDA

- ❖ **Challenges - Dynamic Economic Environment**
- ❖ **Global Practices On Cost Monitoring**
- ❖ **Global vs Indian Scenario**
- ❖ **What India Needs**
- ❖ **Contributing to the Development Agenda**
- ❖ **Leveraging ICAI**
- ❖ **Policy Issues – New Rules...**
- ❖ **Lost Advantage – Internal & External (Government)**
- ❖ **Our Submission**



# DYNAMIC ECONOMIC ENVIRONMENT

## MACRO LEVEL

- Rapid Globalization of Business
- Increased Competition
- Technology as an Enabler
- Strong sector focus
  - Infrastructure
  - Service Sectors
- Significant changes in user behavior and expectations
- Value for money

## MICRO LEVEL

- Large Mergers and Acquisitions
- Changes in Manufacturing methodologies
  - Change of Technology
  - Economies of Scale
  - Outsourcing
  - Networking
- Corporatization of Public Utilities & Social Services
- Corporate Governance & Transparency



**Urgent Need- For a Cost Competitive Nation**

# GLOBAL PRACTICES ON COST MONITORING

- ❖ Cost audit practices in India slightly differ from Global Audits and Costing practices
- ❖ Each country's cost & management accounting practices depend upon the maturity level of its economy in terms of
  - ❖ competitiveness,
  - ❖ liberalisation & globalization,
  - ❖ business pattern/models,
  - ❖ average size/scale of an enterprise,
  - ❖ risk-management models,
  - ❖ market & information network,
  - ❖ level of corporate/enterprise governance,
  - ❖ strategic strengths & weaknesses,
  - ❖ cost-leadership movement,
  - ❖ sustainable cost reduction practices,
  - ❖ extent of applied research, benchmarking, etc.
- ❖ India differs in majority of these factors and the level of its economy, its corporate entities and also the social and political culture.
- ❖ Expert Group constituted by MCA had studied the relevant practices prevailing in many countries such as, UK, USA, Germany, Canada, Japan, Australia, New Zealand, China, France, South Korea, Malaysia, Spain, Argentina, Brazil, Italy, Eastern European Countries, Hong Kong, Pakistan, and Sri Lanka.



**In India, barring few top companies, rest of Corporate India is at very low maturity level in adopting cost management practices – CII Study**

# GLOBAL Vs INDIAN SCENARIO

## GLOBAL

- Large TNC's dominate
- Advanced Cost & Performance Measurement Systems
  - Activity based Costing
  - Target Costing
  - Life Cycle Costing
  - Balanced Score Card
- Advanced Countries US & China seek Cost Data
- Major funding by Investors

## INDIAN

- SME's and MSME's dominate
- Primitive Cost Systems
- Only Financial reporting for Tax & Government Filing
- Cost data limited to Regulators e.g. CERC, TRAI, NPPA etc.,
- Lacks competitiveness
- Major funding by Nationalized banks



**Indian corporate environment needs statutory support for building robust cost accounting and reporting system**

# WHAT INDIA NEEDS...

- ❖ India has to target sustainable development balancing economic growth, environment and social equity through judicious use of resources, resource optimization, and efficient allocation of resources and resource efficiency
- ❖ Creation and optimization of stakeholder value should be the objective of governance and conformance and performance dimension of governance are important to optimize share holders value.
- ❖ Costing methodologies applied in organization, measure the consumption of economic resources and support the accountability of business performance.
- ❖ Cost audit can be used for benefit of management ,consumers and shareholders by helping them to identify their weaknesses in cost management and help drive down costs by detecting wastage and inefficiencies.

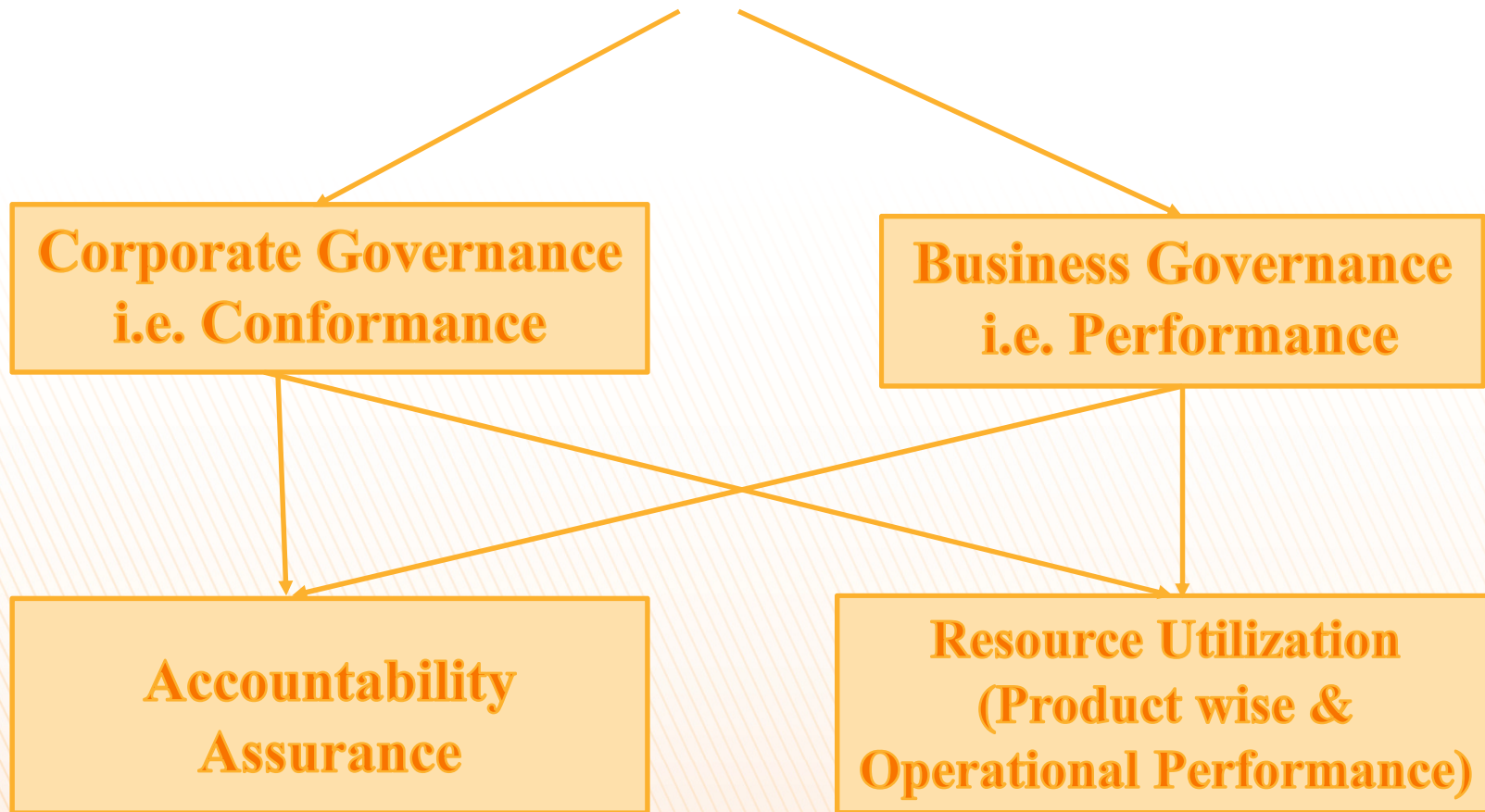


# LEVERAGING ICAI....

- Cost Competitiveness – a main tool for economic growth
- The Institute and the profession delivers specialized stream of professional with unique training in
  - developing systems for Efficient utilization of resources,
  - identifying areas for increasing efficiency,
  - improving productivity,
  - reducing wastages, and
  - enabling sustainable decision making through robust cost and management accounting system.
- The profession is an important part of the team in corporate, government and non-government sectors where cost has a key role to play.
- The concepts, techniques, & standards in this domain are developed by the Institute in consultation with technology, accounting, and process experts.
- Statutorily mandated cost records inculcate uniformity in the methodology and approach to costing.
- Cost Accounting Standards bring in the best practices across the world.
- Cost audit provides assurance on the robustness of the system.



# Enterprise Governance (IFAC on Governance)



**The analysis of Product-wise and Operational Performance of any company needs accurate costing data that should be based on Cost Accounting Standards and Generally Accepted Cost Accounting Principles**



# CONTRIBUTING TO THE DEVELOPMENT AGENDA

## REQUIREMENT

- Sustainable Development
- Balanced Growth
- Environment Safety
- Social Equity

## FULFILLED THROUGH

- Judicious resource utilisation
- Efficient resource allocation
- Optimising productivity
- All the above through
  - Robust Cost Systems
  - Assurance of Cost Systems through Cost Audit

**Only Statute backed and Principle based Cost Accounting & Assurance mechanism in all companies will help achieve Development Agenda of the country**



# POLICY ISSUES – NEW RULES

## • CURRENT MECHANISM SINCE 2011

- Old rule-based system in place since 1965 with lot of adhocism & complexities was reviewed by the Experts.
- Much simplified and more effective mechanism introduced in 2011.
- New mechanism laid greater emphasis of Cost Competitiveness and better Corporate Governance.
- Major shift from Rule based to Principle based mechanism with adherence to Cost Accounting Standards and Auditing Standards.
- Coverage of companies based on minimum threshold limits [no pick & choose of Products or Sectors].
- New policy addressed various issues of all stakeholders.

## • RULES OF 2014

- Retrograde step.
- Reintroduced old Rule based mechanism.
- Removed Principal based mechanism with adherence to Cost Accounting Standards and Auditing Standards.
- Reintroduced pick and choose of products and sectors.
- More complexities.
- Much higher cost of compliance.
- Confidentiality given a go by.
- No help to government, regulators, & management.

**Frequent Changes in Policy shakes the confidence of the stakeholders**

## Non applicability of Rule 2014 to majority of industry/companies though they are covered in category ABCD of the Rule.

- Quick critical analysis of few clauses would reveal [in brief] the following:

a) Category 'A' – No company is likely to be covered under this category for reasons given below. Even if covered, the company would claim exemption under the guise of not disclosing confidential details that may jeopardize security of the country. Such exemptions are already given under the financial disclosures.

Machinery and mechanical appliances cannot be specific to any industry or activity. For example, bearings, power transformers, control panels or other electrical/mechanical equipment are items of general application and can be used in any sector. Hence, no company produces such items exclusively for supply to defence, space and atomic energy sectors. Therefore, if the company supplies even one item to a sector other than defence, space and atomic energy, which is a natural & commercial possibility, then the company would not fulfil the test of “exclusive supply” and will be out of the ambit of application.

The net worth clause and corresponding turnover provided under clause (A) rules out all companies engaged in such manufacturing and supplies.

- Category 'B' – Very few companies are likely to be covered under category 'B' for reasons given below.
- a. Despite MCA's intent to cover all the regulated industries, the proposed rules do not say so as the mandate of regulatory bodies is highly restricted within the same sector. For example, Petroleum and Natural Gas Regulatory Board do not regulate production of petroleum products or gases; or the Airport Economic Regulatory Authority do not regulate aircraft operations or civil aviation activities; or the Telecom Regulatory Authority of India do not regulate the entire value [supply] chain of telecom activities that are now controlled by different companies and majority of them fall out of the purview of TRAI.



## Non applicability of Rule 2014 to majority of industry/companies though they are covered in category ABCD of the Rule.

- b. In a multi-product or multi-service company, reference to specific product or service turnover being more than Rs. 50 crore for records and Rs. 100 crore for audit is misleading.
  - This would imply that in a chemical company producing multiple chemicals, each of its products must satisfy the qualifying turnover.
  - Further, for a pharma company, each drug or formulation produced in various dosage forms such as tablets, capsules, syrups, injectable, ointments, drops are considered as different products. Now even if the company has more than Rs.1000 crore turnover, it may not have any single product [dosage form] with turnover more than Rs.50 or Rs.100 crore.
  - Similarly, Nitrogenous Fertilizer is a separate product different from Potassic, Phosphatic, Mixed or Bio Fertilizers. Even a cement producer can claim OPC, PPC & White cement as different products. This logic can also be extended to the same product having different SKUs.
  - **Therefore, product or service specific turnover criteria as prescribed would lead to exclusion of every company otherwise intended to be covered under these clauses.**
- c. Further, having an individual turnover limit of Rs. 50 crore in multi-product cases and Rs. 25 crore for single product company is contradictory. Majority companies do not restrict their business to only one product or activity. Even if a single product manufacturing company earns 1% revenue from consulting services, it can claim to be a multi-activity company.
- **Given above are few examples and the same logic can be extended to every clause under category 'C' and 'D' and it would be seen that the product is excluded from the ambit of application either because the company does not meet such high threshold limits or being a multi-product company, individual products are outside the ambit.**



# LOST ADVANTAGE - INTERNAL

**Product & Activity-wise Cost Accounting & Assurance mechanism helps in:**

- Strengthening Corporate Governance
  - Enables Independent directors to play an effective role
  - Enables Audit committee to evaluate related party transactions
  - Enables Board in effective Performance Management
- Effective utilization of resources
- Achieving required level of Internal Controls within the company
- Capacity Utilization Analysis
- Input-Output Ratio Analysis
- Energy Efficiency Analysis.
- Analysis of wastages in Raw-materials, Operations, and Finished Goods
- Manpower Productivity Analysis
- Working Capital & Inventory Management Analysis
- Cost data capturing does not cost much to the company as they are pulled from within the system.



**Cost Accounting & Assurance mechanism is the Lifeline for the company to survive & thrive in highly competitive environment.**

# LOST ADVANTAGE – EXTERNAL (GOVERNMENT)

***Cost data is of immense use to various Central Government Organizations and Regulatory Authorities to deal with cases relating to***

- subsidy determination for various products,
- pricing of essential goods and services,
- valuation of goods under anti-dumping and other agreements under WTO,
- verify transfer pricing adopted in related party transactions,
- check cases of predatory pricing and unfair trade practices such as price-rigging, cartelization, over-charging, discriminatory pricing, profiteering, etc.
- detection & prevention of frauds,
- tariff determination under direct & indirect tax laws,
- determination of toll/recovery charges for all infrastructure projects,
- determination of various user charges for public services & utilities,
- protection of interest of consumers, and
- detection of direct tax & indirect tax evasion cases.

**Only Statutory provision would ensure availability of cost details to various government agencies and regulatory bodies**



# Our Submission

- *Principle based Cost Accounting & Assurance mechanism introduced from 2011 [in phases] should be continued.*
- *Coverage of companies should be based on uniform threshold limit across manufacturing and service sectors with no pick & choose of products & services.*
- *Detailed policy review should take place after a reasonable period of time, say 5-7 years and in consultation with all stakeholders.*
- **"With such kind of mechanism, the Companies will be required to maintain cost records which will create competitiveness and help them in sustaining. Once they sustain in the competitive market, there will be:**
  - **More Production**
  - **More Revenues to Government**
  - **More Employment**
  - **Less inflation**
  - **Less NPA"**



**ACHIEVE  
COST  
SAVING**

**THANK YOU**