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December 14, 2013

Mr. Naved Masood, IAS
Secretary to the Government of India
Ministry of Corporate Affairs
Shastri Bhawan
New Delhi- 110 001.

Dear Sir,

Sub: **Draft Companies (Cost Records and Cost Audit) Rules, 2013 – Suggestions by The Institute of Cost Accountants of India.**

This has reference to the Draft Companies (Cost Records and Cost Audit) Rules, 2013 exposed by the Ministry of Corporate Affairs (MCA) under Section 148 of the Companies Act 2013 on 21.11.2013. The Council of the Institute has made detailed deliberations and have also taken in to consideration the series of earlier personal discussions and meetings with your kind office on the subject and we place below our observations and suggestions on the said Rules:

Observations:

1. The Draft Rules have combined both the Cost Accounting Records Rules and Cost Audit Report Rules in one single Rule. It may please be noted that Section 148(1) states that the Central Government is required to "prescribe" particulars relating to the utilisation of material or labour or to other items of cost to be included in the books of accounts. Similarly, Section 148(2) requires the Central Government to direct audit of cost records of such class of companies for which a Cost Audit Report Rules is necessary as in vogue since 1965.
2. Section 148 is applicable to companies "engaged in the production of such goods or providing such services as may be prescribed". The Draft Rules is silent regarding definition of "product" or "services" or "production of goods" or "providing of services". We feel that these definitions are essential and should be an integral part of the Rules for clarity and to avoid any confusion.
3. Section 148(2) requires audit of cost records for class of companies which are covered under Section 148(1) and threshold limits of net worth of such amount or turnover of such amount are required to be prescribed for companies to be covered under audit. We feel that the section contemplates different threshold limits for cost audit. Further, such threshold limits should be prescribed separately for companies engaged in production/manufacturing and providing of services.
4. As mentioned earlier, there should be two separate Rules prescribed for Cost Accounting Records and Cost Audit Report. This has also been the practice from the inception of introduction of cost accounting mechanism in the country since 1965 in line with the financial accounting mechanism. The Cost Audit Report Rules should lay down the reporting formats and the mode of filing the report. It may not be out of place to mention that under the Companies Act 1956, **the cost auditor was responsible to file the cost audit report directly with the Central Government with a copy to the company.** Under the Companies Act 2013, the position has changed and the cost auditor is now required to submit his report with the Board of Directors, which in turn is required to file the report with the Central Government. Hence, it is imperative that clear procedure is laid down for the purpose to avoid any ambiguity.

5. Clause 2(b) of the Draft Rules as defined "cost accountant in practice". There is no term as "cost accountant in practice" in the Cost and Works Accountants Act, 1959 and the same may be contradictory to the provisions of the said Act. Section 2 (1) (b) of the Cost & Works Accountants Act, 1956 defines a "Cost Accountant" means a person who is a member of the Institute and Section 6(1) of the said Act entitles a member to obtain a certificate of practice and practice as a Cost Accountant. Accordingly, clause 2(b) of the Draft Rules be modified.
6. There is no definition of "cost accounting standard" in the Draft Rules which is in Vogue under The Companies (Cost Accounting Record) Rules, 2011 dated 03.06.2011. It may be noted that certain principles for the preparation of cost statements are required to be enunciated to **maintain uniformity in treatment of cost elements across the spectrum of industry**. The Institute has developed 18 "cost accounting standards" and further standards are being developed as a continuous process to help the stakeholders. The process for developing cost accounting standards was initiated by the Institute in consultation with the MCA since 2003 with participation from wide group of stakeholders.
7. In some of the clauses, the class of companies have been identified with the Chapter heading of the Central Excise Tariff Act (CETA), 1985. This is appropriate for identifying classes of companies to be covered under the said Rules. However, in many of the clauses, the type of products mentioned in the clause is not in conformity with the Excise Chapter mentioned in the same clause. This leads to confusion about inclusion of the products/industry covered under the specific Chapter. Further, to avoid any confusion, reference to Chapter heading of the CETA should cover the chapter in its entirety.
8. You would kindly agree with the view that the Draft Rules as exposed has some contradictory clauses and drafting errors have crept in inadvertently. We would like to draw your kind attention to some of these inherent contradictions that have crept in the Draft Rules.
 - a) Clause 3(1)(i) states "Machinery, mechanical appliances used in defence, space and atomic energy" and further provides examples of the sectors in which it is used. Chapter 84 of CETA covers machinery and mechanical appliances. It appears that the intention is to cover all such items covered in the Chapter. However, In view of proviso to the rules which states that "requirement under these rules shall apply to a product or a service for which the individual turnover (from such specific product or such specific service) is rupees one hundred crore or more", it may be argued that the total supply of its products to defence/space/atomic energy etc. is less than Rs. 100 crores and hence the "specified product" is outside the ambit of the Rules. It is not the spirit of the Draft Rules.
 - b) Clause 3(1)(ix) contemplates covering Telecommunication Services. However, the clause is qualified by stating that the services regulated by Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act 1997 are only covered. **The definition should include services that require license or registration with the Ministry of Communications and Information Technology, Government of India and DOT. In the present form, the clause is not equitable.**
 - c) Clause 3(1)(x) contemplates coverage of generation, transmission, distribution and supply of electricity. The clause is qualified by stating that such activity is regulated by the Central Electricity Regulatory Commission. In such a scenario, no electricity generating company, other than few of the Central PSU companies will be covered since all such generating companies are under individual State Regulatory Commissions. It is understood that State Regulatory Commissions under Joint Regulatory Commission are independent and are not subservient to the CERC under the Electricity Act, 2003. **Therefore, it will be appropriate to mention that activities regulated by CERC State Regulatory Commissions and Joint Regulatory Commissions formed under the Electricity Act, 2003 shall be covered.**

- d) Clause 3(1)(xii) contemplates coverage of the Pharmaceutical sector. However, the Draft Rules states active pharmaceutical ingredients or bulk drugs and formulation included in Chapter 30 of the CETA. It may be noted that Chapter 30 deals with Pharmaceutical products whereas the active pharmaceutical ingredients for Bulk Drugs are covered under Chapter 29, which is missing. **It is appropriate to refer to both the Chapters 29 & 30 of the CETA.**
- e) Clause 3(1)(xiii) contemplates coverage of the Fertilizer Industry. The clause also refers to Fertilizers included in Chapter 31 of the CETA. The Fertilizers can be of various types. However, the word "Urea" in the clause raises confusion as to whether only Urea is covered, **hence the Fertilizer products under Chapter 31 of CETA, 1985 be clearly provided.**
- f) There is no clarity in Clause 3(1)(xiv) with reference to the chapter heading of the CETA. There is a need to include Sugar, Sugar product & Industrial Alcohol included in Chapter 17 & 22 of the CETA, 1985.
- g) Clause 3(1)(xv) deals with Petroleum Products under administered price mechanism (Diesel, PDS Kerosene, Domestic LPG and Cooking Gas) or subsidised. Petroleum Sector appears to be also a part of Clause (3)(1)(xix) since all the products included under this clause are part of Chapter 27 of the CETA. Further, Diesel, PDS Kerosene, Domestic LPG and Cooking Gas are all joint products of refining of crude and are produced by cracking of crude. **Presumably the intention is to mandate maintenance of rules from the commencement of the manufacturing process.**
- h) Clause 3(1)(xvi) covers items of the specified industry covered under Chapter 86 of CETA. However, Chapter 85 also includes railways and tramway signalling equipment which are also within the scope of the clause but not covered under Chapter 86. **Reference to both the Chapters 85 & 86 if CETA, 1985 is desirable.**
- i) Mention of "Mineral Fuels, mineral oils etc." in Clause 3(1)(xix) and "base metals" in Clause 3(1)(xx) leads to confusion. **The exact chapter heading 27 mentioning Mineral Fuels & other products as used in the CETA would avoid such confusions.**
- j) Clause 3(1)(xxii) covers "Aircraft, spacecraft, that are funded (investment made in the company) to the extent of 90% or more by the Government or Government Agencies". The industry is entirely under control of the Central Government. The clause "funded (investment made in the company) to the extent of 90% or more by the Government or Government Agencies" is incorrectly drafted and needs to be removed.
- k) Similarly, Clause 3(1)(xxiii) is qualified with "funded (investment made in the company) to the extent of 90% or more by the Government or Government Agencies". The intention is to cover Vehicles, aircraft, vessels and associated transport equipment and components **covered under Chapter 87 to 89 of CETA, 1985 and hence the qualification clause should be deleted.**
- l) Clause 3(1)(xxiv) covers only "Jute and Jute Products" to the exclusion of cotton, silk, woollen or blended fibres/textiles. Such products are included in Chapters 50 to 63 of the CETA. The clause is silent about any reference to the CETA. **It is suggested that Jute and other Textile products covered under Chapter 50-63 of CETA, 1985 should be included.**
- m) Clause 3(1)(xxv) has no reference to the CETA whereas the product code description is covered under Chapters 12 and 15 of the CETA. Reference to the Chapter would avoid

any confusion to the exclusion of the qualifying clause. **It is suggested that Edible oil seeds, oils including Vanaspati & other seeds and plant included in Chapter 12 & 15 of the CETA, 1985 should be included.**

9. It is further noted that certain extremely important sectors that were covered both under cost accounting records rules and cost audit even under the erstwhile product/industry specific regime, have been kept out of the ambit of the Draft Rules. This observation is being made subject to the amendments that are required in the Draft Rules as pointed out in the preceding paragraph for removing the ambiguity and lack of clarity in the Draft Rules. The following issues are of importance and have a bearing on the necessity for inclusion of these sectors within the ambit of cost accounting records and cost audit.
- a) The transition of the Indian economy from being a controlled one to a deregulated one was a momentous step. But if a deregulated economy leads to, for instance, **unhealthy competition or to predatory exploitation of the consumer, the whole objective of making Indian economy liberalized will be defeated.** The Competition Commission of India has been created to prohibit things like anti-competitive agreement, abuse of dominant position by an enterprise and to regulate certain combinations which may include acquisition of shares, acquiring of control and mergers/amalgamation between and amongst enterprises. **Cartels, in India as well as elsewhere, are found to be the most common practice in markets particularly in the intermediate products, i.e. cement, tyres, steel, paper, plantation products etc., that are processed and that form input costs all along several stages of the supply chain with fairly sophisticated customers.**
 - b) Regulation is a complex balancing act between advancing the interests of consumers, competitors and investors, while promoting a wider 'public interest' agenda. The protection of public interest objectives rests with the laws governing competition and the regulatory regimes that have been set up. To play an effective role, these regulatory bodies require cost information from the companies especially when it is doubted that the enterprises are exploiting customers and others or they are resorting to predatory pricing to create artificial entry barriers for others or are unduly cross-subsidizing one class of customers at the cost of the other class of customers. Reliable and certified cost provides necessary basis on which these regulatory bodies can base their decisions to ensure justice for everyone in the market.
 - c) The Government is entering into Free Trade Agreements (FTA) with various countries. To choose products under FTA, we need basic cost data. Similarly, in India, **regulatory mechanism is being strengthened for each and every sector. Availability of detailed cost data is a pre-requisite for the effective functioning of any regulator.** Today, more than 80% of international trade disputes relate to transfer pricing which in-turn requires cost data to determine the arms' length price. Bench-marking and assessment of competitiveness for different industries requires cost data. Competition Commission has been continuously seeking cost data for many sectors.
 - d) A nation's competitiveness is the sum up of individual firm's competitiveness. In the context of a **sustainable competitive infrastructure** which a nation builds, the result is nothing but enduring competitiveness of the nation in the entire globe. The Accounting literature framework postulates that the **competitive environment is a determinant of the form that firm's Cost and Management Accounting (CMA) practices take and the intensity with which they are used.**

- e) The Indian economy has to migrate from the current status to the top end position of the global competitiveness index in a short/medium time span. Considering the maturity levels of cost and management accounting in Indian economy caused by the legacy of protected environment, we have a long way to traverse without the luxury of time. We do not have the luxury of a long experience curve for this to happen and need to work out the strategies including policy intervention which will position cost and management accounting as a soft infrastructure towards building national competitiveness. Mere collection of financial information for financial reporting is not sufficient but the same supplemented with a Costing system drawing on the same data and proper analysis of the same helps the management to make proper decisions.
- f) Cost accounting is the process of accumulating, measuring, analyzing, interpreting, and reporting cost information to both internal and external users showing the relationship between costs and income and intended to bridge the wide gap between Cost & Price in the Public interest and to ensure inclusive growth with equity.
- g) The PAIB of IFAC has issued an IGPG on **Costing to drive organizational performance where in it clearly stated that:** Underlying the importance of cost accounting system, IFAC document says that costing and many costing methodologies applied in organizations, **measures the consumption of economic resources and support the accountability of business performance.** This is best achieved through a system that;
- (i) delivers both cost information and operational feedback for planning, budgeting, cost, and financial accounting purposes, and for operational improvement;
 - (ii) helps to ensure the fulfilment of external reporting and other compliance requirements; and
 - (iii) helps to manage an organization.

In its conclusion it said that **"Costing contributes to an understanding of how profits and value are created, and how efficiently and effectively operational processes transform input into output. It can be applied to resource, process, product/service, customer and channel-related information covering the organization and its value chain. Costing is thus an essential tool in creating shareholder and stakeholder value"**.

- h) Cost audits help to ascertain whether an organization's cost accounting records are so maintained as to give a true and fair view of the cost of production, processing, manufacturing, mining of a product and providing services at affordable prices. Cost audits can be used to the benefit of management, consumers and shareholders by; (a) helping to identify weaknesses in cost accounting systems, and (b) to help drive down costs by detecting wastage and inefficiencies. Cost audits are also of assistance to governments in helping to **formulate tariff and taxation policies.**
- i) Cost audit is a **potent tool for detecting and preventing frauds** and is essential to support the functions of the Serious Fraud Investigation Office (SFIO), which has been strengthened by incorporating new provisions in the Companies Act 2013.
- j) Both the Central Excise Authorities and Income Tax Authorities use cost audit reports extensively to assessment of Tax and to ensure avoidance of tax evasion. The Income Tax authorities have made it **mandatory to file Cost Audit Report along with Tax Audit Report.** Further, with the introduction of Revised Schedule VI, cost audit report is the only source of authentic quantitative data of production and sales which is essential to safeguard the revenue. The cost accounting records and audit thereof also ensures a **structured and systematic inventory valuation.**

- k) Cost information plays a critical role in transfer pricing, predatory pricing, fixation of margin of dumping for the purpose of levy of anti-dumping duty, free trade agreement, consumer protection, revival of sick companies and corporate governance. It is a tool to protect the interests of investors with timely information on wastage and optimum utilization of scarce resources.

Suggestions:

10. In view of the facts stated above, it is imperative that the MCA should consider inclusion of all the sectors that were covered under the ambit of cost accounting records and cost audit cost audit orders dated May 2, 2011, June 30, 2011 and January 24, 2012 so far as the production/manufacturing sector is concerned.

11. Threshold Limits:

- (i) The threshold limits prescribed in the Draft Rules should be modified and amended.
- (ii) It is suggested that every company engaged in any of the activities having a **net worth of rupees five crore or more or having a turnover of rupees twenty crore or more** should maintain cost accounting records.
- (iii) In respect of multi-product companies engaged in specific class of products or services, or where a company is engaged in more than one class of activities attracting the provision of the Rules, the combined class of product of services attracting the rules should be at least 5% of the total turnover of the company or rupees twenty crore whichever is less.

- (iv) All such companies covered under the ambit of maintenance of cost accounting records under Sub-section (1) of Section 148 of the Act for different sectors should be covered under cost audit with the following threshold limits wherein;

a) Companies engaged in Strategic Sectors:

where the net worth as on the last date of the immediately preceding financial year exceeds rupees five crore; or the turnover made by the company during the immediately preceding financial year exceeds rupees one hundred crore.

b) Companies engaged in an industry regulated by a Sectoral Regulator or a Ministry, or Department of Central Government:

where the net worth as on the last date of the immediately preceding financial year exceeds rupees five crore; or the turnover made by the company during the immediately preceding financial year exceeds rupees twenty crore.

c) Other Companies

where the net worth as on the last date of the immediately preceding financial year exceeds rupees five crore; or the turnover made by the company during the immediately preceding financial year exceeds rupees one hundred crore.

d) Companies engaged in providing services

where the net worth as on the last date of the immediately preceding financial year exceeds rupees five crore; or the turnover made by the company during the immediately preceding financial year exceeds rupees twenty crore.

Provided that any company engaged in production of goods or provision of services of such products and activities covered under the Companies (Cost



Accounting Records) Rules, 2013 meant solely for captive consumption or for captive use shall not be covered under these rules.

We are enclosing herewith the following documents for your favourable consideration and official records;

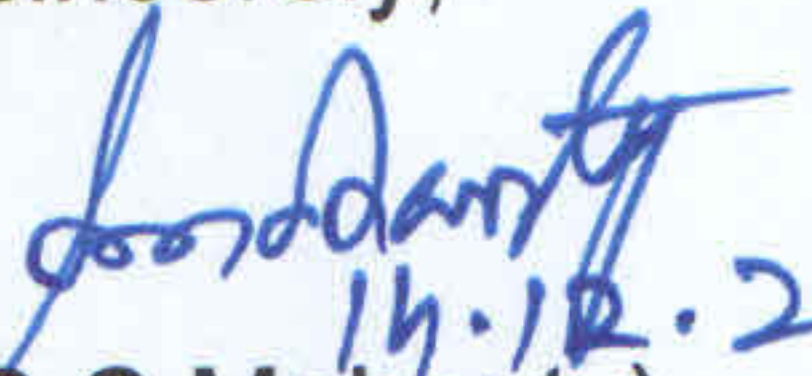
- (i) Suggestions with justifications of the Institute to the Draft Companies (Cost Records & Cost Audit) Rules, 2013;
- (ii) The Companies (Cost Accounting Records) Rules, 2013; and
- (iii) The Companies (Cost Audit Report) Rules, 2013

We sincerely look forward for your favour considerations of our above suggestions for amending the Draft Companies (Cost Records & Cost Audit) Rules, 2013 in the greater interest of the industry, economy and the profession.

We may kindly be allowed to give a presentation on the matter to your kind office at your convenience.

With regards,

Yours sincerely,


14.12.2013
(CMA S.C. Mohanty)
President