COST AUDIT FOR BEGINNERS
• **Cost Audit comprises following:**

  • Verification of the cost accounting records such as the accuracy of the cost accounts, cost reports, cost statements, cost data and costing technique and

  • Examination of these records to ensure that they adhere to the cost accounting principles, plans, procedures and objective.
Objectives of Cost Audit

• Prospective Objective: Under which cost audit aims to identify the undue wastage or losses and ensure that costing system determines the correct and realistic cost of production.
Objectives of Cost Audit

• Constructive Objectives: Cost audit provides useful information to the management regarding regulating production, economical method of operation, reducing cost of operation and reformulating Cost accounting plans.
Types of Cost Audit

- Cost Audit on behalf of the management:
- Cost audit on behalf of a customer
- Cost Audit on behalf of Government
- Cost Audit by trade association
- Statutory Cost Audit
Cost audit on behalf of management

- The principal object of the audit is to see that the cost data placed before the management are verified and reliable and they are prepared in such detail as will serve the purpose the management in taking appropriate decisions.
Cost audit on behalf of customer

• In case of cost plus contracts, the buyer or contractee insists on cost audit to satisfy himself about the correct ascertainment of cost.
Cost audit on behalf of government

• Government may order cost audit to satisfy itself the genuineness of the industry seeking the assistance.
• To establish fair price of any product, government may order cost audit.
Cost audit by trade association

• Where activities of trade association include maintenance of price of the products manufactured by the member units or where pooling or contribution arrangements, the trade association require accuracy of costing information submitted by member units checked.
Statutory cost audit

• This is covered by the provisions of section 233B of the Companies Act.
Cost Audit Procedures

• Cost audit comprises following three steps;
• Review
• Verification
• Reporting
REVIEW

• The cost auditor should familiarise himself with the memorandum and articles of association, past audit reports on the financial accounts, annual reports issued by the board, the chairman’s speech, etc.
REVIEW

• Review the costing system in vogue in relation to the production process and method,
• Should have detailed knowledge of the flow of production process and documents that arise or received in that course.
• A list of cost account books maintained by client should also be obtained.
Review

• Careful study and evaluation of internal controls and their operation on the cost account books.
Review

• Before audit work is taken up, all books and records should be posted up to date, vouchers for the various transactions filed serially and all working sheets made available to the auditors.
Review

• Audit should be conducted with utmost cooperation of the staff.
• Auditor should have knowledge of various standards issued by the Institute.
## Cost accounting standards

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Verification

• A suitable programme for cost audit is made.
• The procedure and programme to be adopted for audit and the various forms and documents used for it should be laid down in Audit manual.
• The audit programme should be drawn out in detail, specifying each item of audit work to be carried out.
Verification of capacities

• Examination of licensed capacity, installed and utilised capacities of various products.
• Reasons for abnormal variance may noted.
Verification of financial ratios

• Financial ratios such as
• Profit as percentage of capital employed,
• Profit as percentage of sales,
• Current assets as a percentage of current liabilities,
• Net worth expressed as percentage of long term borrowings and liabilities.
Verification of financial ratios

• Net worth expressed as a percentage of capital employed,
• Cost of production as percentage of capital employed,
• Cost of production as percentage of working capital.
Verification of production data

• Production in quantities for various products under reference.
• Percentage of production of the product in relation to installed capacity.
Verification of cost of raw materials consumed

• Verify the method of accounting followed for recording the quantities and value of receipts, issues and balances of all materials used in production.

• Verify consumption of major raw materials per unit of production compared with the standard requirement.
Verification of cost of raw materials consumed

• Verify variation in consumption of major raw materials per unit of production as compared to the preceding two years.

• Verify confirmation received form the prarties to whom materials are loaned.

• Verify the system or return of scrap and wastage.
Verification of cost of power & fuel

• Verify the adequacy of records maintained to ascertain the cost of power, fuel, steam etc.
• If purchased, it should be shown separately.
• Allocation of power cost to departments and products has to be verified.
Verification of employee costs

• Verify the total man-days of direct labor available and actual worked in the year.
• Verify the labor cost per unit of product or products under reference.
• Variations as compared to the previous two years.
• Contribution of incentive schemes towards increasing productivity and effect on the cost.
Cost of stores

• Verify the system of stores accounting for recording receipts, issues and balances.
• Non moving items have to be checked.
• Cost per unit of production has to be verified.
Verify provision for depreciation

• Method of depreciation adopted by the company.
• Verify depreciation provided comply with that of companies act section 205 sub –sec 2
• The basis of allocation of depreciation of common assets to the different departments.
• The basis of charging depreciation to the cost of products.
Verification over heads and allocation

• Variations as compared to the previous two years.
• Basis of allocation of overhead to cost centres and absorption to products.
• Comparison of actual with budget and reasons for variation.
• Amount of expenditure compared to the volume of output.
Royalty and Technical aid payments

• Verify the record of basis of calculation and charging of royalty and other allied payments to production cost.
Sales

• Sales in quantity and value for each of the product.
• Average sales realisation per unit.
• Variations compared with last two years.
Verification of abnormal, non-recurring and special costs

• Strikes, lockouts, major breakdowns in the plants, substantial power cuts, serious accident etc., may affect production.

• Costs incurred during that period may verified and excluded from the product cost.
Verification of cost statements

• Determination of cost following the generally accepted cost accounting principles.
• Application of costing system appropriate to the product.
• Consistency in the application of costing system and cost accounting principles.
• Verification of cost statements as to prescribed form and the prescribed content.
Verification of cost statements

• Elimination of material prior – period adjustments.
• Abnormal wastes and losses and other unusual transactions being ignored in determining of cost of product.
• The Costing Accounting Records Rules also prescribe the proforma of the various cost statements.
Reconciliation with financial books

- The cost records should be reconciled with the financial books of account to ensure accuracy.
- The reconciliation should be done in such a manner the profitability of the product can be correctly adjudged and reconciled with overall profit of the company.
- Variations should be correctly indicated and explained.
Audit notes

• In the course of audit, the auditor records on working papers the material facts observed.
• Clarifications and answers may be recorded.
• The power to obtain information and explanations is a tool to accomplish the duty cast on auditor. He should know how to use.
• The auditor has to satisfy himself that the information and data collected and compiled therein are correct and the cost of production determined there form is fair.
Reporting

• With the help of the working papers, an audit report is issued on completion of audit.
• It should summarise the final result of audit.
• Certificate regarding correctness of the accounts should be include in the report.
• The report should consist of notes, observations and comments on the cost accounting system, financial position,
Reporting

- stores and spare parts, depreciation, sales, abnormal non-recurring costs, etc.
- The report may also highlight other points of interest like factors responsible for the increase in cost of production.
- Suggestion regarding improvements and corrective measures to be taken.