

Central Government to Specify Cost Audit for Certain Companies (Sec 148)

1. Legislative background

The notes on clauses to the Companies Bill, 2011 read as follows:

“Clause 148. — This clause corresponds to section 233B of the Companies Act, 1956 and seeks to empower the Central Government after consultation with regulatory body to direct class of companies engaged in production of such goods or providing such services as may be prescribed to include in the books of accounts particulars relating to utilisation of material or labour or to such other items of cost. The Central Government may direct the audit of cost records of the company by Cost Accountant in practice appointed by Board and on such remuneration as determined by the members. The auditor conducting the cost audit shall comply with the cost auditing standards. The clause further provides that the qualifications, disqualifications, rights, duties and obligations as apply to auditor shall also be applicable to cost auditor as well. The Central Government may call for further information and explanation if necessary after considering cost audit report. The clause further defines cost auditing standards. The clause also provides penalty for the company, every officer of the company, cost auditor of the company who is in default, if any default is made in compliance with the provision.”

This section corresponds to section 233B of the Companies Act, 1956. The Central Government, after consultation with regulatory body, may direct any class of companies engaged in production of such goods or providing such services as may be prescribed to include in the books of accounts particulars relating to utilisation of material or labour or to such other items of cost. If the Central Government is of the opinion, that it is necessary to do so, it may, direct that the audit of cost records of class of companies, which are required to maintain cost records and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order. ‘Cost Auditing Standards’ have been mandated.

2. Maintenance of cost records

The Companies (Cost Records and Audit) Rules, 2014 are applicable to every company registered under the Act which are engaged in production of goods or providing of services listed in Table-A or Table-B of Rule 3. Different threshold limits have been prescribed in the Rules for applicability of maintenance of cost accounting records and coverage under cost audit.

Rule 2(e) defines “cost records” as ‘books of account relating to utilization of materials, labour and other items of cost as applicable to the production of goods or provision of services as provided in section 148 of the Act and these Rules’. Any transaction - statistical, quantitative or other details - that has a bearing on the cost of the product or activity is important and forms part of the cost accounting records.

The rule 3 has classified sectors/industries under Regulated and Non-Regulated sectors. The 6 sectors/industries covered under item A of the rules are 'regulated sector' and 33 sectors/industries covered under item B are 'non regulated sector'. For providing further clarity, CETA headings are given against the respective industries. For maintenance of cost records, no distinction is made between companies falling in item A and B.

Every company, including foreign companies defined in clause (42) of section 2 of the Act, engaged in the production of the goods or providing services, specified in Items A and B, having an overall turnover from all its products and services of Rs. 35 crore or more during the immediately preceding financial year, shall be required to maintain cost accounting record.

However, this requirement does not apply to foreign companies having only liaison office in India which are engaged in production, import and supply or trading of medical devices listed in entry 33 of item B. Companies which are classified as a micro enterprise or a small enterprise including as per the turnover criteria under sub-section (9) of section 7 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006) are also excluded from the purview of the rules. Further, as turnover of 'immediately preceding financial year' is required to be checked, every year company has to check the turnover of preceding financial year for maintenance of cost records.

3. Manner of maintenance of cost records

Rule 5 mandates that the cost records for the company including all units and branches shall be maintained in Form CRA-1. Such records are to be maintained for each of financial year commencing on or after 01.04.2014. A relaxation of one year has been given to companies covered in serial number 12 and serial number 24 to 32 of item B of rule 3. They are as follows:

- Coffee and tea (serial number 12)
- Milk powder (serial number 24)
- Insecticides (serial number 25)
- Plastics and polymers (serial number 26)
- Tyres and tubes (serial number 27)
- Paper (serial number 28)
- Textiles (serial number 29)
- Glass (serial number 30)
- Other machinery (serial number 31)
- Electricals and electronic machinery (serial number 32)

Form CRA-1 does not prescribe any format but only provides principles to be followed for different cost elements. Pursuant to sub-rule (2) and (3) of rule 5, the records shall facilitate calculation of per unit cost of production, cost of sales and margin and shall enable the company to control various costs to achieve economies of scale. The principles are in sync with the cost accounting standards. No separate format based records maintenance has been prescribed even for the

regulated industry and the prescription has left it open for industry to maintain cost accounting records according to its size and nature of business so long as it determines a true and fair view of the cost of production, cost of sales and margin of the products/services.

4. Applicability of cost audit

The criteria for applicability of cost audit are different for companies in regulated and non-regulated sector.

For companies under item A:

Every company having annual turnover from all its products and services in the immediately preceding financial year of Rs. 50 crore or more and the aggregate turnover of the individual product or products or service or services of Rs. 25 crore or more.

For companies under item B:

Every company having annual turnover from all its products and services in the immediately preceding financial year of Rs. 100 crore or more and the aggregate turnover of the individual product or products or service or services of Rs. 35 crore or more.

The term 'turnover' is defined in clause (91) of section 2 of the Act. The criterion is two pronged: overall and product-specific turnover. Both criteria are required to be fulfilled. Companies whose revenue from exports in foreign exchange exceeds 75% of its total revenues or companies operating from special economic zones are exempt from the requirement of cost audit.

5. Appointment of cost auditor

The companies falling in rule 3 and fulfilling the criteria in rule 4 shall appoint a cost auditor within 180 days of the commencement of every financial year. Cost auditor, as combined reading of rule 2 (b) and (c) reveals, can be:

- a cost accountant in practice or
- a firm of cost accountants or
- a limited liability partnership of cost accountants

A cost accountant holding certificate of practice on part time basis is not entitled to conduct cost audit. Thus, only a cost accountant in whole-time practice can conduct cost audit. Further, a statutory auditor appointed under Section 139 of the Act cannot be appointed as cost auditor of the company.

Rule 14 of the Companies (Audit and Auditors) Rules, 2014 provides the method of appointment and fixation of remuneration of cost auditors. In the case of companies which are required to constitute an audit committee, the appointment and remuneration of cost auditor will be recommended by audit committee. The

board shall make the appointment and approve the remuneration of cost auditor. The remuneration of cost auditor is required to be ratified subsequently by the shareholders. In the case of other companies, the board shall appoint an individual qualified to become a cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

Ratification of remuneration of cost auditor is a special business and can be so ratified in any meeting of shareholders.

Rule 6 (3) provides that the cost auditor so appointed for a financial year shall continue till 180 days from the closure of financial year or till submission of cost audit report for that year.

Provided that the cost auditor appointed under these rules may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the Cost Auditor and recording the reasons for such removal in writing.

6. Information of appointment of cost auditor

Rule 6 (2) provides for intimation of appointment of cost auditor to the auditor so appointed and to Central Government. Every company which appoints a cost auditor shall inform the said cost auditor of his appointment. While no specific period is provided for such intimation, the same could be intimated while intimating the Central Government. Further, the company shall file form CRA-2 with Central Government within 30 days of passing of resolution in board meeting or within 180 days of the commencement of financial year whichever is earlier.

7. Appointment of cost auditor in case of casual vacancy

Any casual vacancy in the office of a cost auditor shall be filled by the board within 30 days of such vacancy. Such vacancy may arise due to resignation, death or removal. Company shall file form CRA-2 with Central Government within 30 days from the date of appointment.

8. Qualifications, rights, duties and obligations of cost auditor

As provided in sub-section (5) of section 148, the qualification, disqualification, rights, duties and obligations of cost auditor are same as applicable to auditors under Chapter X. Refer section 141, 143, 144 and 145, 146 for detailed commentary on the same.

9. Rotation of cost auditor

The Act does not provide for rotation in case of appointment of cost auditors and the same is not applicable to a cost auditor. It may, however, be noted that though

there is no statutory provision for rotation of cost auditors, individual companies may do so as a part of their policy.

10. Report of cost auditor

The cost auditor, after audit of cost records of company, shall send to the Board his report along with his reservations or qualifications or observations or suggestions. Such report shall be in form CRA-3. The same is required to be sent within a period of 180 days from the closure of financial year.

Within a period of 30 days from the date of receipt of a copy of the cost audit report, the company shall furnish the same to the Central Government in form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014. Such form shall contain full information and explanation on every reservation or qualification in cost audit report. Sub-section (7) of section 148 empowers the Central Government to call for additional information and explanation, if deemed necessary, after perusal of cost audit report and explanations furnished by the company. The company shall furnish the required information within such period as may be specified.

11. Compliance of cost accounting standards

Second proviso of sub-section (3) of section 148 provides that the cost auditor should comply with cost auditing standards issued by the Institute of Cost Accountants of India, with the approval of Central Government

Central Government vide their letter no. 52/33/CAB/2013 [Dated 10.09.2015] has, under section 148(3) of the Act, granted Central Government's approval to the following Cost Auditing Standards:

- (i) Cost Auditing Standard-101 on Planning an audit of Cost Statements;
- (ii) Cost Auditing Standard-102 on Cost Audit Documentation;
- (iii) Cost Auditing Standard-103 on Overall objectives of the independent cost auditor; and
- (iv) Cost Auditing Standard-104 on Knowledge of business, its processes and the business environment.

These Standards shall come into force with immediate effect on the date of its notification.

12. Obligations of a company

Every company required to get cost audit conducted under Section 148(2) of the Act shall:

- a) Maintain cost records in form CRA-1;

- b) Appoint a cost auditor within 180 of the commencement of every financial year;
- c) Inform the cost auditor concerned of his or its appointment;
- d) File a notice of such appointment with the Central Government within a period of 30 days of the Board meeting in which such appointment is made or within a period of 180 days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014;
- e) Within a period of 30 days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report alongwith full information and explanation on every reservation or qualification contained therein, in form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

13. Changes proposed in Companies (Amendment) Bill, 2016

The Companies (Amendment) Bill, 2016 proposes to substitute the words “Cost Accountant in practice”, with the words “cost accountant” in sub-sections (3) and (5). Further, it proposes to substitute the words “Institute of Cost and Works Accountants of India” appearing in explanation to sub-section (3) with the words “Institute of Cost Accountants of India”.

14. Punishment and Compoundability

For contravention by the company of provisions of this section, sub-section (1) of section 147 will be applicable. For contravention of provisions of this section by the cost auditors, sub-section (2) to (4) of section 147 will be applicable.

Contents of Geeta Saar, as extracted from ICSI Premier on Company Law, is as per notified law as on 30th September, 2016.