

**AUDITING**  
**B.Com. IV Semester**  
*Unit IV*  
**Topic: COST AUDIT**

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**Meaning of Cost Audit**

Cost audit may be defined as “the verification of cost records and accounts and a check on the adherence to the prescribed cost accounting procedures and the continuing relevance of such procedures.”

Smith and Day in their book ‘Advanced Cost Accountancy’ define it, “the term ‘Cost Audit’ is meant the detailed checking of the costing system, technique and accounts to verify their correctness and to ensure adherence to the objective of cost accountancy.”

R.W. Dobson Smith and Day in their book Introduction to Cost Accountancy’ defines it, “Cost audit is the verification of the correctness of cost accounts and the adherence to the cost accountancy plan.”

Cost audit is the verification of the correctness of cost accounts and a check on the adherence to the cost accounting plan.

This is, it not only involves the examination of cost accounts but also the fact that the plan prepared in this connection has been duly executed. Cost audit as an audit of the efficiency of minute details of expenditure in which the work is in progress and not a post-mortem examination. The first function of cost audit is the verification of cost accounting records according to the cost accounting system and the second function is the checking on the adherence to the\* cost accounting plan.

## **Objectives of Cost Audit**

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

- ❖ To establish the accuracy of costing data. This is done by verifying the arithmetical accuracy of cost accounting entries in the books of accounts.
- ❖ To ensure that cost accounting principles are governed by the management objectives and these are strictly adhered to in preparing cost accounts.
- ❖ To ensure that cost accounts are correct and also to detect errors, frauds and wrong practice in the existing system.
- ❖ To check up the general working of the cost department of the organization and to make suggestions for improvement.
- ❖ To help the management in taking correct decisions on certain important matters
- ❖ To determine the actual cost of production when the goods are ready.
- ❖ To reduce the amount of detailed checking by the external auditor its effective internal cost audit system is in operation.
- ❖ To find out whether each item of expenditure involved in the relevant components of the goods manufactured or produced has been properly incurred or not.

## **Advantages of Cost Audit**

The important advantages of cost audit are briefly discussed as follows:

### **I. Advantages to the Management**

- ❖ It provides necessary information for prompt decision decisions.
- ❖ It helps management to regulate production.
- ❖ Errors, omission, fraud, and mistakes can be detected and prevented due to the effective auditing of cost accounts.
- ❖ It reduces the cost of production through plugging loopholes relating to wastage of material, labor, and overheads.
- ❖ It can fix the responsibility of an individual wherever irregularities or wastage are found.
- ❖ It improves the efficiency of the organization as a whole and costing system in particular by constant review, revision and checking or routine procedures and methods.
- ❖ It helps in comparing actual results with budgeted results and points out the areas where management action is more needed.

- ❖ It also enables comparison among different units of the factory to find out the profitability of the different units.
- ❖ It exercises a moral influence on employees which keeps them efficient and alert.
- ❖ It ensures that the cost accounts have been maintained under the principles of costing employed in the industry concerned.
- ❖ It ensures effective internal control
- ❖ It helps to increase the overall efficiency of productivity.
- ❖ Inefficiency can be eliminated by suitable corrective actions.
- ❖ It facilitates cost control and cost reduction
- ❖ It assists in the valuation of stock of materials, works in progress and finished goods.

## **II. Advantages to the Shareholders**

- ❖ It enables shareholders to determine whether or not they are getting a fair return on their investments. It reflects managerial efficiency or inefficiency.
- ❖ It ensures true picture of the company's state of affairs. It reveals whether resources like plant and machinery are being properly utilized or not.
- ❖ It creates an image of the creditworthiness of the concern.
- ❖ Advantages to the Society
- ❖ It tells the true cost of production. From this, the consumer may know whether the market price of the article is fair or not. The consumer is saved from exploitation.
- ❖ It improves the efficiency of industrial units and thereby assists in the economic progress of the nation.
- ❖ Since the price increase by the industry is not allowed without justification as to an increase in the cost of production, consumers can maintain their standard of living.

## **III. Advantages to the Government**

- ❖ It assists the tariff board in deciding whether tariff protection should be extended to a particular industry or not.
- ❖ It helps to ascertain whether any particular industry should be given any subsidy to develop that industry.
- ❖ It provides reliable data to the government for fixing up the selling prices of the various commodities.
- ❖ It helps in fixing contract prices in a cost-plus contract.

- ❖ It determines whether differential pricing within the industry is desirable.
- ❖ It helps the government to take necessary measures to improve the efficiency of sick industrial units.
- ❖ It can reveal the fraudulent intentions of the management.
- ❖ Cost statements may be helpful to authorities in imposing tax or duty at the cost of finished products.
- ❖ It facilitates settlement of trade disputes of the companies.
- ❖ It imposes an automatic check on inflation.

## **Disadvantages of Cost Audit**

### **I. Expensive**

One primary disadvantage associated with cost audits is the excessive fees. Auditors are typically independent contractors who can charge relatively high prices for services rendered.

### **II. Lengthy**

Cost audits are also lengthy processes that require employee devotion. Although the auditor may be an outside contractor, employees must provide requested information and be accessible in case further explanation of documents is necessary.

### **III. Lost Time**

Although thorough an auditor's report is usually given three to five weeks after the balance sheet is released. This means people who have been stealing from an establishment have nearly a month to form an excuse or leave the company.

### **IV. Uncertainty**

Because a major part of the process involves estimating there's the possibility of numerical figures being wrong. Besides, if receipts and other forms of record-keeping are skewed an auditor relying on such documents may produce an inaccurate report.

## **Circumstances under Which Cost Audit is Desirable**

The following are the circumstances under which cost audit is ordered:

- ❖ Price Fixation.
- ❖ Cost variation within the industry.
- ❖ Inefficient Management.

- ❖ Tax Assessment.
- ❖ Trade Disputes.

### **Difference between Financial Audit and Cost Audit**

The basic nature of audit is checking and it holds good for both the cost audit as well as the financial audit. However, the following are the points of difference between these two audits:

<b>Financial Audit</b>	<b>Cost Audit</b>
It is statutorily compulsory under Companies.	It is not compulsory except in certain cases
It covers all the financial transactions recorded in financial books and financial records.	It covers only cost records and cost accounts.
It aims to examine that business transactions have been recorded correctly.	It aims to verification of cost accounts and ensures the plan prepared in this connection has been duly executed.
It is concerned with the past and history.	It concerned with a forward-looking approach.
Reporting the true and fair view of the company's earnings and state of affairs.	Cost Auditor is required to report to the management except for statutory audits.
The financial aspect of the accounts is a matter of concern.	The cost aspect of the account is of main concern.
It is concerned with the scrutiny of	It is concerned with the propriety and

reliability or otherwise of transactions.	efficiency of the transactions.
The financial audit is primarily concerned to serve the interests of the shareholders.	The cost audit is concerned to serve the interests of the management.
The role of the financial auditor is in the office	The role of the cost auditor is in the factory.
A financial audit is conducted every year.	Cost audit may be done in the year in which it is required by the government or any other agency.
In a financial audit, an auditor has to check the exact value of the closing stock for the balance sheet.	In a cost audit, an auditor has to check the adequacy of the stock keeping in view the needs of the concern.
In the financial audit, the report is submitted to the management to be laid in the general meeting of the shareholders.	The report of the cost auditor is submitted to the company and also to the company law board.

### **Cost Audit Program**

A suitable program for cost audit should be drawn out in detail, specifying each item of audit work to be carried out. An audit program is a written plan prepared by the Cost Auditor showing the following salient features:

How much work is to be done?

Who is going to do a particular portion of work?

And what is the duration of time by which the work is to be finished?

## **Areas Where Cost Audit Program is Carried Out**

The areas which a cost audit program should include are as below:

*Inventory of stores and work in progress;*

*Labor;*

*Overheads;*

*Selling, distribution, office and administrative expenses;*

*Capital expenditure;*

*Utilization of capacity, plant, and equipment.*

*Thankyou.....*