

WELCOME

-: Presentation on :-

***Intricacies of Cost Audit and Cost Records Rules
in
ENGINEERING SECTOR***

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CMA Amit Apte

- Over **27 years of post qualification experience** in the fields of **Costing, MIS, Finance & Accounts** and **ERP Systems implementation**.
- **PRESIDENT, The Institute of Cost Accountants of India (2018-19)**
- **Chairman WIRC of ICAI (CMA) 2010-11, CCM ICAI (CMA) 2011-19**
- **Director**, Levare Consultants Pvt. Ltd. & Levare Info Solutions Pvt. Ltd.
- **Partner**, Joshi Apte & Associates, Cost Accountants
- **Partner**, Unique Valuers and Techno-Financial Consultants LLP
- **Ex-Member Independent Evaluation Committee** constituted by IBA under RBI's "Framework for Revitalizing Distressed Assets in the Economy"
- Ex-Member – "**RBI Committee on Cost of Government Banking**" – received special acknowledgement of efforts and contribution.
- **All India Ranking** in the ICAI (CMA) Final examinations. **Topped Pune University** in Diploma in Taxation Laws Examinations.
- **Registered Valuer** – Securities & Financial Assets
- Qualified Company Secretary.
- **Global exposure** – Overseas stints in UAE & Egypt.
- Adventurous – Independent treks to over 10 Himalayan destinations including **Mt. Everest Base Camp**. State Level representation and Meritorious Performance at Table Tennis Tournaments.

History of Cost Audit

- In **1965** the Companies Act, 1956 was amended to incorporate the provisions relating to the maintenance of Cost Accounting Records and Cost Audit.
- Cost Accounting and Cost Records under Section 209 (1) (d)
- Cost Audit under Section 233B
- Cost Audit Orders to **individual companies**
- **Physical** submission of Cost Audit **Reports**
- **2011** - rules and reporting formats were simplified to address industry concern of confidentiality.
 - Industry applicability
 - XBRL based consolidated reporting
 - Principal based rules
- The **Companies Act, 2013** has retained the provisions relating to maintenance of cost records and cost audit under Sec 148.
- **2014** - rules were notified considering the new Companies Act 2013

Difference Between Cost Audit and Financial Audit

	COST AUDIT	FINANCIAL AUDIT
Meaning	Independent examination of the correctness of the cost statements, and its conformity with the cost accounting principals.	Independent examination of finance books and records, so as to express the opinion on it.
Audit	Performed by a practicing Cost Accountant.	Performed by a practicing Chartered Accountant.
Appointment of auditor	Board of Directors	Shareholders
Analyzes	Cost records, cost statements and cost accounts.	Financial Statement, Books of Accounts, Documents, Vouchers, etc.
Emphasis	Analysis of the efficiency of operations and propriety of actions of the management.	Compliance with the accounting standards and effectiveness of the internal control system.
Applicability	Specified industries meeting turnover criteria	Compulsory for all companies.
Report submission	To Board of Directors	To the Shareholders.

Threshold limit for applicability

	Regulated Sector Industries	Non-Regulated Sector Industries
Maintenance of Cost Accounting Records	Gross Turnover of Companies covering products & services Rs. 35 Cr.	Gross Turnover of Companies covering products & services Rs. 35 Cr.
Cost Audit	1. Gross Turnover of Companies covering products & services Rs. 50 Cr. And 2. Turnover of individual products / Services covered for Maintenance of Cost Records – Rs. 25 Cr	1. Gross Turnover of Companies covering products & services Rs. 100 Cr. And 2. Turnover of individual products / Services covered for Maintenance of Cost Records – Rs. 35 Cr

Exceptions to maintenance of Cost Records & Cost Audit

- **Maintenance of Cost Records**

- Micro enterprise (Plant and Machinery or Equipment not more than Rs.1 crore and Annual Turnover not more than Rs. 5 crore)
- Small enterprise (Plant and Machinery or Equipment not more than Rs.10 crore and Annual Turnover not more than Rs. 50 crore).
- Foreign companies having only liaison offices.

- **Cost Audit**

- Companies whose revenue from **exports** in Foreign Exchange exceeds **75%** of total revenue **Or** Companies operating from **SEZ**
- which is engaged in generation of electricity for captive consumption through Captive Generating Plant. For this purpose, the term “Captive Generating Plant” shall have the same meaning as assigned in rule 3 of the Electricity Rules, 2005;

Applicability

Based on

- Industry
- Threshold limit of turnover

INDUSTRY

(A) Regulated Sectors-

Sr. No	Industry/Sector/Products/Service
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- | | |
|---|---|
| 1 | Telecommunication services |
| 2 | Generation, transmission, distribution of supply of electricity |
| 3 | Petroleum products |
| 4 | Drugs and pharmaceuticals |
| 5 | Fertilizers |
| 6 | Sugar and industrial alcohol |

Applicability

(B) Non- regulated Sectors-

Sr. No	Industry/Sector/Products/Service
1	Machinery and Mechanical appliances used in defense, space and atomic energy sectors excluding any ancillary item or items.
2	Turbo jets and turbo propellers
3	Arms and ammunitions
4	Propellant powders; prepared explosives (other than propellant powders); safety fuses; detonating fuses; percussion or detonating caps; igniters; electric detonators
5	Radar apparatus, radio navigational aid apparatus and radio remote control apparatus
6	Tanks and other armored fighting vehicles
7	Port services of stevedoring, pilotage, hauling, mooring, re-mooring, hooking, measuring, loading and unloading services rendered by a Port in relation to a vessel or goods
8	Aeronautical services

Applicability

Sr. No	Industry/Sector/Products/Service
9	Steel
10	Roads and Other infrastructure projects
11	Rubber and allied products
12	Coffee and tea
13	Railway or tramway locomotives, rolling stock, railway or tramway fixtures and fittings, mechanical (including electro mechanical) traffic signaling equipment's of all kind.
14	Cement
15	Ores and Mineral products
16	Minerals fuels (other than Petroleum), mineral oils etc.
17	Base metals
18	Inorganic chemicals, organic or inorganic compounds of precious metals, rare-earth metals of radioactive elements or isotopes and Organic Chemicals

Applicability

Sr. No	Industry/Sector/Products/Service
19	Jute and Jute products
20	Edible Oil
21	Construction Industry
22	Health services, namely functioning as or running hospitals, diagnostic centers, clinical centers or test laboratories
23	Education services, other than such similar services falling under philanthropy or as part of social spend which do not form part of any business
24	Milk powder
25	Insecticides
26	Plastic and Polymers
27	Tyers and tubes
28	Paper
29	Textiles

Applicability

Sr. No	Industry/Sector/Products/Service
30	Glass
31	Other machinery
32	Electricals or electronic machinery
33	Production import and supply or trading of following medical devices, namely : <ol style="list-style-type: none">i. Cardiac stents;ii. Drug Eluting stents;iii. Catheters;iv. Intra ocular Lenses;v. Bone Cements;vi. Heart valves;vii. Orthopedic implants;viii. Internal prosthetic replacements;ix. Scalp vein set;x. Deep brain stimulator;xi. Ventricular peripheral shud;

What is Engineering Industry

- **8 Main Types of Engineering Industries**

- Mechanical engineering
- Chemical engineering
- Electrical engineering
- Civil engineering
- Aerospace engineering
- Environmental engineering
- Biomedical engineering
- Software engineering

- **Encyclopedia**

- Engineering can take a variety of forms — **civil, military, or mechanical**
- term 'engineering industry' is normally used in a more limited sense to describe the industry devoted to the manufacture of **engines, machine-tools, and machinery**

Major differences in manufacturing and engineering industry

Manufacturing Industry	Engineering Industry
Mass production of tangible goods, such as automobiles, pharma, electronic devices, or FMCG products.	Designing, construction, and maintenance of infrastructure , machinery etc.
Normally batch / process costing relatively less complex	Job costing or project-wise costing
Fixed manufacturing location	Locations can be transient
Can be made to stock	Normally made to order
Manufacturing process normally automated	Manufacturing process normally labour centric
Costs are accumulated over multiple cost centers and then charged to individual products based on cycle time or some other cost driver	Costs are accumulated over individual job / project. Costs accumulated to service cost centers are only charged to individual job, project on suitable basis
Calculation of capacity normally simple	Calculation of capacity normally complex

Applicability

(B) Non- regulated Sectors-

Sr. No	Industry/Sector/Products/Service
1	Machinery and Mechanical appliances used in defense, space and atomic energy sectors excluding any ancillary item or items.
2	Turbo jets and turbo propellers
6	Tanks and other armored fighting vehicles
10	Roads and Other infrastructure projects
21	Construction Industry
31	Other machinery
32	Electricals or electronic machinery

Peculiarities of Engineering Industry

- **Customization**
 - Design
 - Design modifications
 - Planning
 - Material selection as per specifications
 - Tailored manufacturing processes

- **Project-based costing**
 - Material cost
 - Labour requirement
 - Rentals & terrain related costs
 - Project specific costs

Peculiarities of Engineering Industry

- **Uncertainty and risk**
 - technical challenges,
 - regulatory compliance,
 - unforeseen delays
 - Contingency planning
 - Scope changes

- **Life cycle costing**
 - Multiple Accounting periods
 - initial investment
 - maintenance
 - repair
 - disposal costs
 - Revenue recognition & CWIP

Peculiarities of Engineering Industry

- **Resource planning**
 - Raw materials
 - Skilled labour
 - Equipment
 - Energy

- **Compliance with regulations**
 - Labour Laws
 - Safety
 - Environmental laws
 - Clean Rooms
 - additional costs

Factors impacting costing in Engineering Industry

- **Resource planning**
 - Project Scale
 - Project Complexity
 - Geographical Location
 - Material sourcing and transport
 - Regulatory requirements
 - Sustainability cost

- **Compliance with regulations**
 - Labour Laws
 - Safety
 - Environmental laws
 - Clean Rooms
 - additional costs

3. Cost Accounting Policy

- (1) The policy should cover, inter alia, the following areas:
 - a) Identification of cost centres/cost objects and cost drivers.
 - b) Accounting for material cost including packing materials, stores and spares etc., employee cost, utilities and other relevant cost components.
 - c) Accounting, allocation and absorption of overheads
 - d) Accounting for Depreciation/Amortization
 - e) Accounting for by-products/joint-products or services, scrap, wastage etc.
 - f) Basis for Inventory Valuation
 - g) Methodology for valuation of Inter-Unit/Inter Company and Related Party transactions.
 - h) Treatment of abnormal and non-recurring costs including classification of other non-cost items.
 - i) Other relevant cost accounting policy adopted by the Company
- (2) Briefly specify the changes, if any, made in the cost accounting policy for the product(s)/service(s) under audit during the current financial year as compared to the previous financial year.
- (3) Observations of the Cost Auditor regarding adequacy or otherwise of the Budgetary Control System, if any, followed by the company.

Annexure specific issues

Capacity

- Capacity shall be determined in terms of units of production or equivalent machine or man hours.
- Installed capacity is determined based on-
 - i. manufacturers' Technical specifications;
 - ii. capacities of individual or interrelated production centers;
 - iii. operational constraints or capacity of critical machines; or number of shifts
- In case manufacturers' technical specifications are not available, the estimates by technical experts on capacity under ideal conditions shall be considered for determination of installed capacity.
- Normal capacity shall be determined vis-a-vis installed capacity after carrying out adjustments for
 - i. holidays, normal shut down days and normal idle time;
 - ii. normal time lost in batch change over;
 - iii. time lost due to preventive maintenance and normal break downs of equipment's;
 - iv. loss in efficiency due to ageing of the equipment; or
 - v. number of shifts;

Annexure specific issues

A. 4.PRODUCT/SERVICE DETAILS (for the company as a whole)				[REDACTED] LIMITED	
Name of Product(s) /Service(s)	UOM	CTA heading (wherever applicable)	Whether Covered under Cost Audit Yes / No	Net Operational Revenue (net of taxes, duties etc.)	
				Current Year 2021-22 Rs.	Previous Year 2020-21 Rs.
1.A	Nos	84099120	Yes	1,40,76,39,027	1,06,61,97,356
2.B	Nos	84099120	Yes	5,56,65,277	3,75,60,600
3.C	Nos	84099120	Yes	75,79,383	47,03,347
4.D	Nos	84099199	Yes	6,34,10,63,947	6,40,46,80,655
5.E	Nos	84133090	Yes	4,50,26,55,263	4,30,95,99,544
6.F	Nos	84099199	Yes	2,60,69,05,536	2,48,11,04,910
5.Spare Parts		-	No	13,26,49,544	13,86,98,104
6.Other		-	No	8,94,40,65,748	9,19,39,83,294
7.Scrap Sales		-	No	3,18,13,626	2,07,59,936
					-
Total Net Operational Revenue of Manufactured Product or Service				24,03,00,37,351	23,65,72,87,746
Other Operating Incomes of Company				-	-
Total Operating Incomes of Company				24,03,00,37,351	23,65,72,87,746
Other Incomes of company				5,57,63,700	10,41,91,441
Total Revenue as per Financial Accounts				24,08,58,01,051	23,76,14,79,187
Exceptional and Extra Ordinary income				-	-
Other Comprehensive Income, if any				-	67,36,324
Total Revenue including extra ordinary income, if any				24,08,58,01,051	23,76,82,15,510
Turnover as per Excise / Service Tax/ GST Records				36,70,75,42,743	36,48,46,64,163
Difference				(12,62,17,41,693)	(12,72,31,84,976)

Notes:-

The difference in sales as per financial records and as per GST returns is mainly on account of the following reasons :

- i. Interunit transfers
- ii. Assesible value under reverse charge mechanism
- iii. Warehouse Sales
- iv. Credit notes
- v. Asset sale

The company has compiled a detailed reconciliation for the same.

Annexure specific issues

A-4 – Product Details

The difference in sales as per financial records and as per GST returns is mainly on account of the following reasons:

1. Interunit Transfers
2. Reverse Charge Mechanism
3. Warehouse Sales
4. Asset Sales
5. Credit Notes

For Engineering Industry

- i. Financial turnover is inclusive of net adjustment between closing and opening WIP but taxable turnover as per GST return is only the amount of Work Bill Receipts.
- ii. Total taxable turnover as per GST return is the combination of Work Bill and advance receipt / recovery from client but the turnover as per financial report does not include advance receipt from client to the turnover.

Annexure specific issues

B-1 – Quantitative Information

PART-B

FOR MANUFACTURING SECTOR

1. QUANTITATIVE INFORMATION (for each product with CTA ⁹¹ Heading separately)			
Name of Product			
CTA ⁹² Heading			
Particulars	Unit	Current Year	Previous Year
1. Available Capacity			
(a) Installed Capacity			
(b) Capacity enhanced during the year, if any			
(c) Capacity available through leasing arrangements, if any			
(d) Capacity available through loan license / third parties			
(e) Total available Capacity			
2. Actual Production			
(a) Self manufactured			
(b) Produced under leasing arrangements			
(c) Produced on loan license / by third parties on job work			
(d) Total Production			
3. ⁹³Production as per Excise/ GST records			
4. Capacity Utilization (in-house)			

Annexure specific issues

B-1 – Quantitative Information

Construction of industrial plants, structures and facilities are the number of Equipment /parts of equipment manufactured / sold. Since each equipment is unique in nature

The production and sales quantities in case of Construction of industrial plants, structures and facilities are the number of Equipment /parts of equipments manufactured / sold. Since each equipment is unique in nature, there will not be a like to like comparison with previous Year Figures.

Some of the ancillary equipment is also dispatched in other unit of measurements. The same is also converted to numbers and reported here.

Annexure specific issues

B-1 – Quantitative Information

The company manufactures various kinds of equipment for the projects. There is no standardization in the equipment being manufactured. The company is into Projects business whereby the equipment manufactured are a part of the end projects. The revenue of the company is reported under the head "Distilling Equipment". Keeping in view all these constraints, the capacity installed and utilisation is not reported.

Annexure specific issues

B-1 – Quantitative Information

No standardization in the projects being executed

The company is in the business of Engineering and Construction. It executes work on the basis of contracts. The company executes projects in sectors of transportation, power, water supplies, industrial construction etc. There is no standardization in the projects being executed. As such the capacity installed and utilisation is not reported.

Also the quantities in the services provided and actual sales are the number of projects being executed.

Annexure specific issues

B-2 – Abridged Cost Statement

Comparison with previous years figures

The production and sales quantities in case of Construction of industrial and non industrial plants, structures and facilities are the number of Equipment manufactured / sold. Since each equipment is unique in nature, there will not be a like to like comparison with previous Year Figures.

Documentation & Disclosures

- Maintain appropriate documentation to support cost audit findings and cost calculations.
- Include details of cost variances, cost control measures, and recommendations for improvement in the cost audit report.
- Disclose relevant cost-related information in the cost statements, including cost accounting policies, cost data, and any exceptional or non-routine items impacting costs.
- Footnotes

IndAS 11 – Construction Contracts

- **Ind AS 11 – Construction Contracts**

- A construction contract is a contract specifically negotiated for the **construction of an asset or a combination of assets** that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

16. Contract costs shall comprise:

- (a) costs that relate **directly to the specific contract**;
- (b) costs that are **attributable** to contract activity in general and can be **allocated** to the contract; and
- (c) such other costs as are specifically **chargeable to the customer** under the terms of the contract.

IndAS 11 – Construction Contracts

- **Ind AS 11 – Construction Contracts**

Costs that **relate directly** to a specific contract include:

- (a) site **labour** costs, including site supervision;
- (b) costs of **materials** used in construction;
- (c) depreciation** of plant and equipment used on the contract;
- (d) costs of **moving** plant, equipment and materials **to and from the contract site**;
- (e) costs of **hiring** plant and equipment;
- (f) costs of **design and technical assistance** that is directly related to the contract;
- (g) the estimated costs of **rectification and guarantee** work, including expected warranty costs; and
- (h) claims** from third parties.

IndAS 11 – Construction Contracts

- **Ind AS 11 – Construction Contracts**

18. Costs that may be **attributable to contract activity in general and can be allocated to specific contracts** include:

(a) **insurance**;

(b) costs of **design and technical** assistance that are not directly related to a specific contract; and

(c) construction **overheads**.

IndAS 11 – Construction Contracts

- **Ind AS 11 – Construction Contracts**

20. Costs that **cannot be attributed to contract activity** or **cannot be allocated** to a contract are excluded from the costs of a construction contract.

Such costs include:

- (a) **general administration** costs for which reimbursement is not specified in the contract;
- (b) **selling costs**;
- (c) **research and development** costs for which reimbursement is not specified in the contract; and
- (d) **depreciation of idle plant and equipment** that is not used on a particular contract.

IndAS 11 – Construction Contracts

- **Ind AS 11 – Construction Contracts**

22. When the **outcome** of a construction contract can be **estimated reliably**, contract revenue and contract costs associated with the construction contract shall be recognised as revenue and expenses respectively by reference to the **stage of completion** of the contract activity at the end of the reporting period.

An expected loss on the construction contract shall be recognised as an expense immediately in accordance with paragraph 36.

THANK YOU !

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