

Government may rethink compulsory cost audit as industry not keen

Even after a November 2012 government order that made it mandatory for all companies with a turnover exceeding Rs 100 crore to hire a cost auditor, there is resistance from certain quarters. Unlike in the case of a financial auditor, whose appointment is ratified by shareholders, the appointment of a cost auditor has to be cleared by the government.

The Institute of Cost Accountants of India (ICAI) noticed something was amiss when the website of the ministry of corporate affairs (MCA) did not accept appointments of cost auditor. "On November 6, 2012, the government came out with an order superseding all earlier orders regarding cost audits. However, the ministry's e-filing mechanism has never accepted cost auditor's appointment under it," said Ashish Thatte, chairman, western india regional council, ICAI.

Since its inception in 1965, the need and necessity of cost audits has been time and again emphasised. The mechanism of cost audit establishes the link between all input factors such as raw materials, labour, power, etc., and the product price to find out the gross margins. Thus, the data is crucial in cases where the government wants to curb profiteering.

A case in point could be the National Pharmaceutical Pricing Authority fixing the price of drugs. Similarly, in the much-talked-about Fiat India excise duty case, it was the cost audit, that enabled the excise department to conclude that goods were sold below cost. However, the ministry, faced with e-presentations from corporate houses, may be taking a relook into the matter.

According to Mohan Joseph, additional secretary, ministry of corporate affairs, "The ministry has received several representations from industry associations requesting a review of the notifications issued by the cost audit branch in November, 2012. These notifications are currently being reviewed by the ministry."

But the Institute of Cost Accountants of India — a body established by law of Parliament — is clueless about this. "The reason for the inability to appoint cost auditors has not been communicated by any concerned authority till now," confirmed ICAI's Thatte. The question that crops up is whether corporate houses are resisting a compulsory cost audit to hide some of their inadequacies.

Gathering cost data of all players in an industry, year after year, can help in benchmarking, which will highlight outliers. "In steel billets or ingots manufacturing it takes around 1,000 units of power to process one tonne. However, if some company is consuming substantially more or less power, it will be a clear case to probe for possible irregularities," said Dhananjay Joshi, a practicing cost accountant and a former president of the institute.

A company booking false invoices for purchase of raw materials, and thereby availing extra CENVAT credit and simultaneously also lowering taxable profits, would be exposed through cost audit because its process loss would overshoot the average.

Helpful for Govt

The cost audit mechanism helps various authorities and departments in the government access essential information in preventing profiteering or tax evasion. The Fact Finding Committee set up in 1997 under Justice Rajindar Sachar had observed that mandatory cost audit is necessary to serve social objective and consumer protection. Justice Sachar also warned that unless cost audit is done, the government would not be in a position to control high prices of pharma and several essential items.

Similarly, SK Shingal, the then chairman of the Central Board of Excise and Customs, had said in 2008 that cost audit reports provide the perfect basis for cross verification by central excise officers. "But since this report is not available for many units manufacturing excisable products, it puts the department at a great disadvantage," he had observed. The committee on subordinate legislation under the 14th Lok Sabha had recommended extending the scope of cost audit to even the services sector. It acknowledged the importance to authenticate cost database to various government agencies, revenue authorities, regulatory bodies, banks as well as financial institutions, particularly, "in view of a number of cases of financial irregularities in the corporate sector recently coming to light."

Industry Opposes

Nevertheless, the industry associations continue to resist the mechanism. "Given the time and resources involved in complying with such (cost audit) orders, these regulations clearly serve no valuable purpose. It's a retrograde step," mentioned Arbind Prasad, director general, Federation of Indian Chambers of Commerce and Industry (Ficci).

According to Subodh Kumar Agrawal, president of Institute of Chartered Accountants of India, "... it (the cost audit order of Nov 2012) also increases the burden on the part of companies in covering and conducting cost of audit of so many activities." He further

added that many companies are not comfortable with sharing the cost information through cost audit report to a third party due to fear of data theft.

"The industry has been posing the same set of objections for all these years," said Dhananjay Joshi. "In reality , compliance cost of cost audit is hardly anything for a company and needs to be measured against the socio-economic benefits for the country as a whole. The companies which are law abiding, selfdisciplined and possessing a respect for accounting data find no difficulty in complying. In fact, hosting a party would cost more than a cost audit."

He also pointed out that the new cost audit rules have considerably reduced the disclosure requirements and hence addresses the confidentiality issue as well.

Ministry officials did not respond to ET's queries on whether any independent study has been conducted in checking the industry's claims. One of the industry representative bodies confirmed on condition of anonymity that no study has been conducted to estimate the cost of compliance. Cost accounting professionals fear the audit mechanism could die a natural death, if the ministry gives in to industry pressure. Their fears may not be unfounded.

According to Mohan Joseph, the ministry has already formed a consultative mechanism of stakeholders to reexamine and recast all existing rules under the old Companies Act to align with the new Companies Bill 2012, which has been cleared by Parliament and is awaiting ascent from the President . "We have made strong representations to the Ministry of Corporate Affairs.

If there is rethinking in the ministry, a significant change is possible in cost audit rules," said a senior industry official who's in touch with the ministry on the matter. The Institute of Cost Accountants of India, however, doesn't have any representation on the informal committee deliberating the new rules. In an election year, when the black money circulation in the economy typically goes up, these developments assume a greater significance.

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