

COST AUDIT BASED ON AUDITED FINANCIAL DATA AND TECHNICAL INFORMATION: A PRACTICAL ANALYTICAL FRAMEWORK

Abstract

Cost audit is not a mere extension of financial audit. It combines audited financial statements with technical and operational information to derive meaningful product-wise cost, capacity, and efficiency analysis. This article explains how audited financial data form the foundation of cost audit, while technical data provide the basis for cost interpretation, overhead absorption, and capacity utilization analysis along with reciprocal consumption of utilities. This discussion highlights practical issues in single-product and multi-product industries, especially in utilities-intensive sectors such as power and refineries. The article concludes that effective cost audit depends on the integration of audited financial data with technical evidence and professional judgment. In fact cost audit prefers cost efficiency over expense allowability.

Introduction

Cost audit occupies a distinct place in the Indian professional framework. Unlike financial audit, which primarily verifies the truth and fairness of financial statements, cost audit examines how resources are consumed and how efficiently operations are carried out. The Institute of Cost Accountants of India recognizes that cost auditing involves the audit of cost statements and related data, and that the methodology differs fundamentally from financial audit.

In practice, the cost auditor often begins with



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audited financial figures already accepted by the entity and verified by the financial auditor. These figures form the quantitative base for further cost analysis. However, financial figures alone do not reveal product-wise usage, process efficiency, or capacity-related information and cost consciousness. For that reason, technical data from production, engineering, and operations become essential to the cost audit function. Hence Cost audit starts where financial audit ends.

Cost audit and financial data

Audited financial data are indispensable in cost audit because they provide a verified starting point for analysis. Salaries, utilities, packing expenses, consumables, repairs, and other overhead items are initially recorded in financial books and audited under the financial reporting framework. The cost auditor does not ordinarily re-audit these transactions as financial items; instead, the auditor analysis and classifies them for cost purposes. The basic principle for cost audit is all expenses are not

cost but all cost are expenses.

This distinction is important. A cost auditor is not merely repeating the financial audit exercise. Rather, the auditor uses the audited expense base to determine how those expenses should be assigned to products, departments, and activities and finally cost objects. In this sense, financial audit ends with the verification of expense occurrence, while cost audit begins with the analytical use of those expenses for cost ascertainment and operational insight. The cost auditor do not consider entire audited expenses to the cost ascertainment. The cost auditor certify that expenses as cost to the target cost object/s based on benefits generated but the source to find out cost is obviously audited expenses.

Technical data in cost audit

Financial data alone cannot explain how efficiently a business converts inputs into outputs. Technical data are therefore essential for understanding material consumption ratios, labour productivity, machine utilization, process losses, and output norms. ICMAI's standards framework also reflects this broader scope by treating cost audit as a professional exercise involving cost statements and non-financial data, not merely financial figures.

For example, in manufacturing or process industries, the auditor may need information on standard input-output ratios, machine hours, operating capacity, wastage norms, and technical yield. Such data enable the auditor to interpret whether the expenditure recorded in the financial accounts is aligned with the actual level of output. Without these inputs, the cost auditor cannot meaningfully evaluate efficiency or abnormal consumption. Cost incurred at actual capacity utilized vs. cost would have incurred in achievable capacity determined as per ICMAI cost accounting standard may be a useful information to the audit committee for comparison of their position in the market.

Overheads and cost classification

One of the most important tasks in cost audit is the reclassification of financial expenses into cost elements. Items shown in the profit and loss account as "other expenses" may later become manufacturing overheads, administration overheads,

selling overheads, or distribution overheads for cost reporting purposes. Similarly, employee costs may be analyzed across direct labour, indirect labour, and departmental overhead functions.

This conversion is not mechanical. It requires understanding of the business process and the purpose of each expenditure. For example, electricity used in production may form part of manufacturing overhead, while packing material may be traced directly to the product or assigned to packing overhead depending on the system adopted. The cost auditor's role is to interpret the same financial data through the lens of cost behaviour and cost object relevance. Similarly while in financial books it is easier or less time consuming to determine other expenses but in cost account we need to find out manufacturing OH which consists of salary/ depreciation / electricity even travelling expenses of production departments. Similarly we need to find out administrative OH of manufacturing activities and also for office administrative OH in which salary of the executives, electricity consumed requires to add to find out the correct OH. In financial books it is suffice to capture the salary as employee cost but in cost account it needs to break. But one must keep in mind that primary source of cost data is obviously fin data but in analytical way. A excel based iteration for reciprocal consumption of utilities may be shared to those who are in refinery audit and to find actual consumption on demand.

Capacity utilization analysis

Capacity utilization is a critical area where cost audit adds value beyond financial audit. Financial statements do not normally state installed capacity, normal capacity, or actual utilization. Yet these measures are essential for understanding why cost per unit may rise or fall. When utilization is below normal levels, fixed costs are spread over fewer units, resulting in higher unit cost even though the expenditure base remains unchanged. Hence kaizen costing technique may be useful tool to enhance the profit.

This issue is especially significant in industries such as refineries, chemicals, steel, and power generation, where production processes are capital intensive and technically complex. In such sectors, the cost auditor must rely on technical records

to determine output levels and capacity use. The resulting analysis helps management understand whether high cost arises from inefficiency, under-utilization, process constraints, or external conditions. In refinery process gain or loss abnormal or normal can not identify from fin data but using fin data blended with technical information resulted to correct cost per unit of output.

Single and multi-product industries

The nature of the product mix also affects the cost audit approach. In a single-product industry such as electricity generation, the cost object is relatively simple, and most expenses can be traced or allocated using a limited number of technical parameters. In a multi-product industry such as a refinery, however, the auditor must deal with joint products, by-products, common utilities, and interdependent processes.

In such cases, the use of iterative or reciprocal allocation methods may be necessary to deal with the interrelationship among utilities such as water, steam, and heat. The financial data still provide the base amounts, but technical analysis determines how those amounts are to be distributed across all activity centres and outputs. This makes cost audit both more demanding and more informative in complex industries.

Practical significance

The practical significance of cost audit lies in its ability to convert financial data into operational intelligence. The audited trial balance and profit and loss account supply the starting numbers, but the real value of cost audit comes from combining those numbers with engineering, production, and process information. This is consistent with ICAI's approach that cost auditing is a separate professional discipline with its own objectives, standards, and reporting expectations.

The result is a cost audit report that can support pricing, efficiency improvement, performance analysis, and regulatory compliance. In industries covered by Section 148 of the Companies Act, 2013, cost records and cost audit are statutory mechanisms intended to improve transparency and resource use. For this reason, the cost auditor's work should be viewed not as a duplicate of financial audit, but as an analytical extension of audited

financial information into the realm of operational cost measurement. Hence cost audit is sum total of financial data as primary resources and technical data and mandatory secondary source. It is expected that department of expenditure under the ministry of finance must have authenticated data regarding consumption of imported inputs in consumer goods along with industrial products

Conclusion

Cost audit cannot be performed without audited financial data, but financial data alone are not sufficient. The discipline depends on the integration of verified expense figures with technical and operational evidence. This combination allows the auditor to assess capacity utilization, overhead absorption, abnormal consumption, and product-wise cost behaviour.

A well-prepared cost audit report therefore reflects both accounting discipline and industrial understanding. It begins with audited financial records, but it reaches its conclusion only after applying technical analysis to those records. That is what gives cost audit its practical value in modern industry. Hence effective cost audit is possible while one have audited expenses and authenticate technical details.

Expectation: To make it more value addition to cost audit report if we present the effectiveness of each activities performed for delivery of output at factory gate in terms of input output ratio, use of product mix to get maximum capacity utilized and finally determining cost at achievable capacity instead of actual capacity utilized as separate enclosure subject to management discretion. In fact simultaneous conduct of both fin & cost audit clubbed with internal audit may be dream of author. At present as per CRA3 the cost captured reportable product based on actual capacity utilized. But if a separate analysis is allowed to disclose the cost data on achievable capacity as per ICAI cost accounting standard and compare with actual capacity cost data, management can identify the reasons of unexpected loss etc. **MA**

References

1. *Section 148 of the Companies Act 2013.*
2. *Cost Accounting standard as recognised in 2011 notification by MCA*