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MESSAGE

It gives me an immense pleasure to note that the **Confederation of Indian Industry (CII)** in association with **The Institute of Cost Accountants of India** has prepared a knowledge study entitled “**Cost Effectiveness through Cost Audit**” to be released in a seminar on this topic on 18th November 2014 at Haldia. I believe that a glance through the pages of this study will definitely enrich the knowledge base of readers.

In cost-effectiveness analysis it is conventional to distinguish between the direct and indirect costs, productivity costs or intangibles and may be difficult to quantify, should be included in the cost profile. Cost-Effectiveness is required to minimize cost and ensure optimum utilization of resources. Here the cost audit can play a big role to fulfill the objective of cost-effectiveness. The cost audit can act as a driver to bring cost effectiveness and assist in decision making procedure. Thus it is found beneficial to the Investors, Government, Tax Authorities, Consumers and Industries.

The quality of cost-effectiveness analyses is highly dependent on the quality of effectiveness data used. The CMAs with expertise understanding and acquaintance can play a key role in spearheading the economic recovery process in the Indian Economy by efficiency, productivity, competitiveness and effectiveness of the industry. The Cost and Management Accountants possess the expertise which can help in value maximization and business sustainability.

I hope that the readers will undeniably take pleasure in reading the case studies placed in this volume. I wish the seminar a grand success.

CMA (Dr.) A. S. Durga Prasad



MESSAGE

I am extremely happy that **CII Eastern Region** in association with **The Institute of Cost Accountants of India (ICAI)** will organise a one-day Seminar on **Improving Cost Effectiveness through Cost Audit** on 18 November 2014, in Haldia.

We all know how cost and competitiveness have become crucial to the success and sustainability of businesses. In fact, it is the password for it. In a growing economy like India, effective and judicious use of resources is a major challenge and the survival and growth of an organization largely depends on competitiveness and parameters such as adaptability, innovative technology, quality, effective time management, and most crucially COST.

Cost Audit focuses on performance evaluation and its effectiveness in general. It helps improve performance and production efficiencies by detecting and reducing deviations from standards, both visible and invisible losses, inefficiencies, wastages, time overruns etc.

That explains why CII and ICAI have come together to organize the day-long seminar where speakers will discuss in detail some modern approaches, tools and techniques and best practices adopted by industries globally.

I am confident that the panelists at the Seminar will come out with some resource-efficient solutions which will go a long way in helping companies gaining global competitiveness. Sustainability after all is all about driving cost savings through efficiencies, creating new markets and securing competitive advantage.

Competitiveness is a comprehensive concept, and I am also confident that the points and perspectives which are going to be offered by the panelists will be of immense value. I wish the Seminar on Improving Cost Effectiveness through Cost Audit a resounding success.

A handwritten signature in black ink, reading "Viresh Oberoi".

Viresh Oberoi
Chairman – CII Eastern Region



MESSAGE

I am extremely happy that **CII Eastern Region** in association with **The Institute of Cost Accountants of India (ICAI)** will organise a one-day Seminar on **Improving Cost Effectiveness through Cost Audit** on 18 November 2014, in Haldia.

Cost Audit is one of the most effective tools for identification of the errors and irregularities in any system which leads to wastage of valuable resources. It provides enough scope for rectification of those errors and effectively implement systems required for cost reduction and enhancing productivity.

Entrepreneurs need to have clear understanding of operational and marginal cost for appropriate decision making. Existing process is to be redesigned and revisited for effective time management mechanism for better labour productivity and increase in efficiency. Cost Audit thus may be a very effective tool for affective decision making.

In the present scenario companies are very much pro to good corporate governance for improving their relation with the shareholders and other stakeholders. Cost Audit also helps the industry to prepare various budgets well in advance of the actual production based on the data generated from current operations.

I am very confident that this seminar will come out with very effective and gainful takeaways for the participants and will definitely be helpful the industries they represent. I wish more sessions on this subject would be carried out by ICAI and CII in future.

Appreciating the efforts put in both CII and ICAI, I wish the Seminar on Improving Cost Effectiveness through Cost Audit a resounding success.

A handwritten signature in blue ink, appearing to read 'Umseh Chowdhary', with a stylized flourish at the end.

Umseh Chowdhary
Chairman – CII West Bengal State Council



MESSAGE

It is a great pleasure for me to know that **CII Eastern Region** in association with **The Institute of Cost Accountants of India (ICAI)** is organising a one-day Seminar on **Improving Cost Effectiveness through Cost Audit** on 18 November 2014, in Haldia.

In the present scenario, cost audit has come to create immense impact on the industry. The cut-throat competition and competitive pricing can only be addressed through strong costing practices and reliable cost data in the decision making process. Cost audit provides information and data to regulate production, detecting errors and irregularities, if any, reducing wastage of resources, constant reviewing and monitoring regular procedures and methods, compare profitability in multi plant situation and so on.

Cost Accounting not only deals with items of cost and expenses with respect to operations but also provides important post profit or loss analysis results and indicators to identify the reasons behind the results. I am sure that this seminar will provide enough information on the current tools and techniques as well the best practices followed globally in the cost audit domain.

I wish this Seminar on Improving Cost Effectiveness through Cost Audit a grand success.

A handwritten signature in blue ink, appearing to read 'S K Behera', written on a white rectangular background.

S K Behera

Chairman – CII MSME Sub Committee



MESSAGE

I am extremely happy that **CII Eastern Region** in association with **The Institute of Cost Accountants of India (ICAI)** will organise a one-day Seminar on **Improving Cost Effectiveness through Cost Audit** on 18 November 2014, in Haldia.

Business sustainability depends largely on cost and competitiveness. In a growing economy, effective and wise use of productive resources is a major challenge. The survival and growth of an organization depends on competitiveness and competing edge of various parameters like adaptability, innovative technology, quality, effective time management and most importantly the “COST”. Thus Cost Audit focuses on performance evaluation and its effectiveness at large. It helps improve performance and production efficiencies by detecting and reducing deviations from standards, both visible and invisible losses, inefficiencies, wastages, time overruns etc.

I am confident that this Seminar will act as an effective knowledge sharing platform on cost audit mechanism, tools and techniques. It will definitely help participants from the industry to get a deeper insight into the best practices in the cost audit domain adopted globally.

I wish the Seminar on Improving Cost Effectiveness through Cost Audit a great success.

A handwritten signature in black ink, appearing to read 'A K Dey'.

A K Dey
Chairman – CII Haldia Zonal Council

CMA MANAS KR. THAKUR

CENTRAL COUNCIL MEMBER

CHAIRMAN, RESEARCH, INNOVATION & JOURNAL COMMITTEE



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MESSAGE

I am elated to know that the **Confederation of Indian Industry (CII)** in association with **The Institute of Cost Accountants of India** has prepared a knowledge study entitled “**Cost Effectiveness through Cost Audit**”. It comprises of various articles related to the Role of Cost Audit on Cost-Effectiveness.

Cost effectiveness analysis is an efficient way to evaluate projects, programs or sectors evaluation when the main objective of the policy can be reduced to a single result. This tool is designed for the economic analysis of the operational objectives at different levels. Cost Audit helps in cost effectiveness and improving performance in the competitive world through Business Process Re-engineering (BPR), Target Costing, Supply Chain Management (SCM), etc. It helps in Performance Appraisal, Resource Mapping, Risk Mapping, Price Mechanism, Related Party Transaction, Segment Reporting and prevents Inventory Manipulation Frauds. Under this situation, Cost –Effectiveness has become key issue for socio-economic sustainability.

Over the years, leaders at the helm of CII have proved themselves to be visionary industrialists. CII has been a constant reinvention of itself into an institution that today is not only leading industry, but working for the progress of the nation as a whole. It is our privilege to get associated with them and carry out such a Knowledge Study for socio-economic growth through Cost-Effectiveness.

I would like to express my heartfelt thanks to CMA (Dr.) Debaprosanna Nandy and his team and the CII for their sincere effort and support to publish this Knowledge Study in time.

I am sure the readers will find it effective and would love to go through the Knowledge Study. I welcome the readers to put forward their valuable feedback.

CMA Manas Kumar Thakur

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CONTENTS

14

Cost Effectiveness through Cost Audit

CMA Dr. Sanjay R Bhargave

19

Cost Records & Cost Audit - A Helping hand for Cost Competitiveness, An Inside approach of Indian Corporates

CMA Himadri Roy

26

Cost Audit as a tool of Cost Effectiveness

CMA Krishanu Pal

Ms. Sudipa Sarkar

32

Linkage between Cost Record & Cost Audit through major elements of Cost

From Institute's Desk



Cost Effectiveness through Cost Audit

CMA Dr. Sanjay R Bhargave

Central Council Member -

The Institute of Cost Accountants of India

In India, Government started verifying cost structures of the firms around 100 years back when large firms were given contracts by Government of India on "Cost Plus" basis.

The Companies Act 1956 vide Sec 209(1) (d) of the Act, prescribed maintenance of Cost Records. In the year 1965, provisions related to Cost Audit were inserted vide Sec 233 (B) of the Act. Under these provisions, cost audit was required to be done by companies engaged in production, processing, mining and manufacture of various products.

Government of India, Ministry of Corporate Affairs, vide order No.2/1/2008-CL.V dt.21st January 2008, constituted an Expert Group to review and suggest development of cost accounting methodologies and standards to increase the competitiveness of the Indian manufacturing sector and to advise the Government suitable measures for the same. The recommendations of the Expert Group shifted the focus of the cost records from "rule based" to "principle based".

The Companies Act 2013 also provides for maintenance of Cost Records and Cost Audit under Sec 148(1) and 148(2) of the Companies Act, 2013.

Cost Accounting Records help in decision making and guiding for better resource management. It has also brought consciousness among Indian industries in the use of cost information. Cost Accounting Records and Audit thereof is found useful to Industry, Government, Tax Authorities, Investors and Consumers. In the era of competition, prices of the goods are dictated by the market or consumers and therefore the industry has to monitor the costs accordingly by using the Target Costing Technique. Cost Records and Audit thereof provides reliable data base for analyzing the trend and behavior of the costs, maintenance of costs and controlling the costs. It helps the various stakeholders in the following way.

A. Benefits to Industry

1. Help to Management, Directors and Industry:

The Cost Accounting Records (CARR) and Audit thereof provides reliable and authentic data to the management in understanding and taking decisions in following areas:

- Segment-wise performance and major costs affecting performance.
- Product-wise performance and



major costs affecting performance.

c) Internal Control Systems, their adequacy and improvement, if any.

d) Details of operational and non-operational income and expenses and its effect on operational performance.

e) Make or Buy decisions.

f) Optimum utilization of resources :- Cost Audit improves efficiency of the organization by ensuring effective utilization of resources through the analysis of cost data and avoidance of wastages highlighted by Cost Audit. It helps in making the industry competitive both in the national and the global market place and also leads to good corporate governance. Business sustainability depends greatly on cost competitiveness.

g) Opportunities and threats:- Analysis of the data available in cost accounting records helps management to understand the trend of sales realization, behaviour of costs which helps management to understand the opportunities and threats to the business, decide whether to continue production of continuous loss making products, revival of business and overall sustainability of business.

The Companies (Cost Audit Report) Rules 2011 introduced a concept of "Performance Appraisal Report". This report is to be submitted by the Cost Auditor to the Board of Directors only and is not required to be filed to the Central Government.

This is a landmark in the history of companies in India, as this is the first time that a statutory auditor (Cost auditor) has to offer comments on the performance of the company. Performance appraisal Report contains performance indicators such as knowing how well the company is doing, whether it is meeting its goals, whether its customers are satisfied and whether appropriate actions have been taken to improve efficiency etc. The report is

more on principle based than format driven. Here the role of the cost auditor is to provide an independent view of the performance of the company to enable the management to take corrective steps wherever necessary. The suggested areas to be covered in Performance Appraisal Report are :-

1. Capacity Utilization Analysis. :- Cost audit and cost accounting make easy the allocation of common cost and assets amongst different segments for segment reporting and provide reliability to cost information given under financial accounts.
2. Productivity / Efficiency Analysis.
3. Utilities / Energy Efficiency Analysis.
4. Key Costs & Contribution Analysis.
5. Product / Service profitability Analysis.
6. Market / Customer profitability Analysis.
7. Working Capital & Inventory Management Analysis.
8. Manpower Analysis.
9. Impact of IFRS on the Cost Structure, Cash Flows and Profitability.
10. Application of Management Accounting Tools.

Non-executive (independent) Directors can be better equipped and appraise the operational performance and efficiencies in operations with the help of classified information maintained and collected in a systematic manner in the process of Maintenance of Cost Accounting Records, Cost Audit and Performance Appraisal Report.

2. Related Party Transactions.

The cost audit facilitates cost information required for transfer pricing, inter unit transfers and transfers amongst the related parties. The information in respect of international as well as domestic transfer pricing can be derived from



the cost records and audit thereof. It is pertinent to note that the Tax Audit Report under Income Tax mandates submission of copy of the Cost Audit Report. Thus the Cost Audit Report helps in cross checking the data required for tax audit and helps in minimising litigations.

3. Quantitative Information

In view of change in the Schedule VI information, Annual Report does not contain any quantitative details. Under the circumstances, Cost Audit Report is the only source which provides authentic data.

4. WTO and Anti-Dumping

The companies, against whom the anti-dumping cases are filed, are required to prove that their international selling prices are not less than indigenous cost. Similarly lodging of complains against foreign rivals for dumping, etc. and determination of compensation essentially requires a proper cost database.

5. Cost Accounting in Service sector

The growth rate of service sector in India has brought new dynamism in Indian economy. Also Service sectors such as IT & ITES, Banking, Insurance, Health Services, Education, Hospitality management, communication, infrastructure related services etc. have attained strategic importance to the economy and the public at large. The cost advantages give tremendous edge to service sector in negotiating trade prospect, give them competitive advantage and enable them to adopt scientific cost

management practices for a long-term sustained growth.

B. Benefits to Government

6. Helps the Government in Policy Making

Cost data enables government in policy making e.g., Free Trade Agreements which require analysis of cost data for each product for favourable negotiation, Anti-Dumping which is based on verification of cost data of the industry, subsidies to industries, Transfer pricing, pricing of scarce resources and the like.

The cost audit also helps the government in working out concessional rate, utilities like power, water etc., loans at concessional rates and concessions in taxes in addition to outright subsidies.

7. Preventing Inventory Manipulation

Cost accounting provides cost information for valuation of inventory based on cost records maintained for each products/ services and gives no leverage to the management in manipulating stock valuation. The cost audit report also requires the cost auditor to report under-valuation/ over-valuation of opening/ closing stock in the financial accounts and also to give reconciliation of profits between financial and cost records.

C. Benefits to Tax Departments

8. Excise and Income Tax Departments

Cost audit and cost accounting provides



cost information relevant to the Excise Department and Income Tax department enabling them to establish input-output ratios, norms for wastages, appropriate consideration of the capacity of the units. This helps in reducing revenue leakages and also reduction in tax related litigations. Cost Audit Report helps the Revenue Department in Related Party Transactions and analysis of Segmental Profitability. Excise Department is using CAS-4 certificate issued by Cost Accountants in practice for valuation for captive consumption. Cost accounting and Cost Audit is a valuable tool for VAT authorities in determining / justifying VAT liability.

Proper cost accounting records and cost audit helps the exchequer, manufacturer as well as service provider in determining the correct service tax liability and thereby reducing the unwarranted litigations to the minimum possible level.

It is pertinent to note that Under Rule 22 of the Central Excise Rules, 2002 and Sec 44 of the Income Tax Act 1961 the submission of cost audit report to the tax authorities is mandatory.

D. Benefits to Regulators

Cost audit helps the regulators in fixation of prices /tariff based on reliable and verifiable cost data leading to better regulation of industry keeping in view the interests of the consumers. Cost Audit Reports are of immense use to the Regulators and various agencies of the Government in areas like, subsidy determination, administered pricing, predatory pricing, check price rigging, cartelization, discriminatory pricing, profiteering, siphoning of funds.

E. Banks and Financial Institutions

(i) In cases of restructuring of loans or enhancements of facilities when the performance of the companies are not up to the mark, banks and financial institutions, among other things, ask for the Cost Audit Report. The cost audit report helps banks to check the operating efficiency, working capital management, working below capacity, inventory management, abnormal costs etc.

(ii) Cost Audit and cost records also help the corporate / bankers/ financial institutions in deciding upon matters related to risk assessment and efficient risk management

F. Protection of Investors' Interest

The investors of a company are always interested in the working of the company to know the prospect and safety of their investment. This essentially involves proper utilization of materials, labour and other resources, waste reduction to ensure maximum return on and reliability of investments made. Proper system of Cost Audit ensures investor protection.

G. Benefits to Economy

In the absence of an integrated cost management culture, the cost of products and services become avoidably prohibitive which lead to inflation, increase in current account deficit and will also greatly impact the flow of Foreign Direct Investment into the country which may decelerate the growth rate of Indian economy.

H. Benefits to Consumers

The Cost Accounting helps the consumer in getting the commodities at a fair and competitive price and also protects the consumers from unscrupulous trade practices.



Consumers are not against the profit earned by the manufacturer because it is necessary for the survival and sustainability of the business. However, with the help of cost records overpricing of the essential commodities, medicines can be arrested.

I. Cost of the Cost Audit.

The above discussions highlight the usefulness or effectiveness of cost audit. It is worth to note that maintenance of cost records or cost audit is not at all a costly affair. A study on Benefits and Costs of Cost Audit Mechanism was undertaken by the wellknown Institute – Gokhale Institute of Politics and Economics (Deemed University) . The Gokhale Institute of Politics and Economics is one of the oldest research and training institute in India. It was founded in 1930 with an objective to conduct research into the economic and political problems of India and has set the highest standards for quality research in a number of branches of economics. The study revealed that following are the benefits of cost audit mechanism as perceived by the Auditee firms

1. Bringing Cost Consciousness among the industry.
2. Validated cost and profitability of the industry.
3. Determining costs and prices for industry.
4. Determining costs and prices for regulators.
5. Determining proper duty payments and duty credits for the Indirect Tax Authorities.
6. Unit wise profitability, non cost items and its implications, transfer pricing

etc for Income Tax Authorities.

7. Anti Dumping Duties, Valuation under Customs.
8. For Competition Commission of India - Predatory pricing, Anti Cartel etc.
9. For Financial Institutions – early warning of sickness.
10. Consumer Protection – Reasonableness of costs and prices, monitoring by Government.
11. Investor protection – sustainability of company.
12. Measurement of International Competitiveness.

As per the study report the average fees for cost audit are Rs.25628/- per 100 crores of turnover. This clearly shows that the cost of the cost audit is less than 0.1 % .

As regards the concerns of the auditees regarding data leakages and confidentiality, it is observed that submission of cost audit data through XBRL and product group mechanism has brought the data leakage to almost zero level.

J. Conclusion.

Considering the benefits of the cost audit to the various stakeholders and the cost of the cost audit, it can be said that cost records and cost audit mechanism has made formidable contribution in bringing cost effectiveness and cost consciousness amongst industry.

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Cost Records & Cost Audit - A Helping hand for Cost Competitiveness An Inside approach of Indian Corporates

CMA Himadri Roy
Consulting Associate
SVG & Associates

Many of us are aware about the wholesome benefits of cost records and cost audit towards the various outside stakeholders such as the government, the regulators, the economic policy framers etc. After the 2011 reform, the cost records and cost audit mechanism in present structure have even become more efficient while taking due care about secrecy of sensitive cost information. Under the new revamped regime, the information shared by a cost audit report and its annexures, now have come to become more structured by being brief but efficiently informative.

However, the purposes of the cost records and cost audit mechanism are not merely to serve to the external stakeholders, rather the mechanism has more potentially to serve to the internal increasing demands of structured information that can easily match with the very distinctive and flexible operating culture of different organisations. The objective of this article is to highlight these internal benefits or rather demands for such an instrument to be in place. If we think liberally then we could find out that under the present competitive business environment, the traditional financial accounting is losing its gravity day-by-day pushing the business leaders to think about more efficient cost & management accounting. It's not about merely preparing the gross state of affairs of an organisation, but to analyse them and prepare structured

information pin-pointing the core areas of efficiencies and deficiencies. And here comes the necessity to have a full-fledged operative costing atmosphere, a requirement to have micro-level accounting and reporting along with the already present macrolevel financial accounting. Let us discuss the matter in a more comprehensive and communicating way with the following potential questions that we often enquire, being an entrepreneur or business leader, about the viability of cost records and cost audit.

- Why I require a separate costing system when I already have efficient financial accounting in place? At first, we must keep in mind that costing system is not a very different system from that of traditional financial accounting. The basic data for preparing costing records come from the same primary book of accounts alike financial accounting. But what makes a real difference is that for cost accounting, being a micro-level accounting, detailed/segregated accounting entries in basic records is prerequisite for efficient costing system which might not have that much relevance for macro-level financial accounting. That's why we use to say that efficient cost accounting ensures proper control on business data. Being micro-level accounting, cost accounting replicates the true performances of each product/services distinctively enabling the management to have full knowledge of cost-benefit information



about every single product/service. And this is not all. If conditions permit, the cost records have the potentiality to even pin-point each single activity in order to judge their performances in terms of monetary value. This serves as a key information to take decision to reassign or re-shuffle activities involved in a product or service, if required, ultimately resulting in improved earning capacity reflected through gross financial results.

- India now has open liberalised economy. Therefore, all companies are expected to have their own customised MIS system in place to have right information at right time for their own self-existence. Then why the statutory mandate for cost records and cost audit? Is not it a further burden on companies? It is true that the union government took a bold step in 1991 towards making Indian economy an open and liberalised one. Until then almost twenty-three years elapsed and we have seen certain steps to achieve the goal set in 1991. However, until today India is not recognised as a country to have fully open and liberalised economy. We are making our steps towards the same but are still in developing stage. Almost all the economic researches have highlighted this point. In the prevailing economic situations in India, mostly a few big companies with international presence are having effective cost based MIS reporting in place. However, the majority part of public and private sectors are still depends solely on the macro-level financial accounting and as such they give the benefits of cost records a miss. Most of them are still playing only in the national level and as such have not faced the highly cost-conscious

global counterparts in their respective fields of operation. Although most of our Indian entrepreneurs theoretically accept and acknowledge the benefits of cost records, however, in practical, somehow we fall short to implement them. Therefore, to make the Indian economy truly efficient and to make all contributors to it ready to face-off global challenge of cost competitiveness, it is totally justified on part of government/regulators to mandate for compulsory cost records and cost audit. The objective is to create an effective cost culture among industries. It is expected, that after the push on part of government and after testing the benefits of cost records, organisations would continue to do so in a self-driven self-motivated way. In developed economy, efficient cost culture is a common factor across industries which nurture the same in a selfgovernance way. However, our case is in not that much same and certainly we require a push towards the same. An efficient costing system is a prerequisite of a good MIS reporting structure too. In absence of proper cost records, an MIS reporting structure might not serve the very objectives of the same. Therefore, in no way, mandatory application of cost records and cost audit should be seen as a further burden on companies considering its manifold benefits to the maintaining organisations.

- In developed economies, there are no such provision of mandatory maintenance of cost records. Then why should we take a distinctive stand? It is true, that there are no such provision of mandatory maintenance of cost records in most of the developed economies.



However, that does not mean that importance of cost records are not being felt by them, rather they use to rigorously maintain the same as a key decision making tool. The cost records are being maintained there as a part of integrated total accounting system. The forces behind the same are market driven which bound the stakeholders to efficiently maintain the system in a self-motivated way. However, as we already discussed in the earlier point that the prevailing scenario of Indian economy is still a different and therefore required government's support. It should also be noted here that in some of the most developed economies, there are no mandate for financial audit for all (which only applies on meeting some conditions by organisations), but in India we are following a different approach on the same issue based on prevailing economic scenario. In an ideal economy, all participants to it shall adhere with highest norms of ethical practices and principles in a self-driven mechanism. As the practical scenario defers from that of what we say as an 'ideal economy', therefore still we need some 'guiding force' to lead us.

- What about the incremental cost that an organisation has to bear for maintaining separate sets of cost records and conducting audit thereof? Should an organisation be expense prone while being cost competitive? As already stated above that although cost records are a separate set of accounting records based on costing methodology, however, the preparation of cost records are being done based on the same basic sources of general accounting records such as posted accounting vouchers, accounting transactions, journals, ledgers, etc. Therefore, it can be said that cost accounting and financial accounting can easily co-exist in harmony. That is why the incremental cost associated to prepare cost records are very nominal which includes mainly

investment in human resources (viz. hiring some professionally equipped persons as employee, training of ground level employees to make them understand how for each transactions entries are required to pass and with what details etc.) and might require some enhancement in information technology support. But at the end of the day all such nominal investments lies with the organisation and the organisation starts to get the benefits of micro level cost accounting resulting in more focused and structured MIS reporting facility with pinpoint information about key points of the organisation's operating performances. Nowadays almost all mid-term to big organisations have started to utilise several ERP packages to manage their business affairs. Therefore, these organisations can incorporate their automated cost records based on their own specific nature of activities through customisation mode. This helps an organisation to have automated cost records prepared through their ERP packages that gives the entity to have the real time access of updated cost records at any point of business cycle without any manual intervention. However, the same requires one time investment for customisation and development of automated cost records. Organisations which are comparatively small and do not want to invest now for their low volume business transactions, may opt for spreadsheets to generate cost records in structured format. However, cost records through spreadsheets would require manual intervention and as such can only be prepared for a given period. By doing so a small organisation can detour any immediate substantial investment but with a limitation of not to get real time access of cost records as and when required at any point of business operation. Cost competitiveness does not mean to avoid any extra cost even if the same has the potentiality to fetch comparatively healthy benefits, rather investment in potential resources increases ones competitiveness



compared to others. The one who moves first has always an extra edge to be more beneficial as any newly implemented system improves day-by-day through its practical utilisations.

- Tell me in brief about the extra edge that I would get by maintaining cost records. As stated earlier that cost accounting records, being micro-level accounting records, has the clear edge over macro-level financial accounting in terms of identifying core areas of strengths and weaknesses. As such, for maintaining cost records an organisation can expect the following benefits that are otherwise not possible by maintaining only financial accounting records.
- Better control on each significant cost elements and thus getting ability to judge their proper feasibility.
- Better control on each significant resources and thus ensuring their optimum utilisation.
- More structured MIS reporting mechanism enabling pin-point information about each activity/process and thus making it possible for their distinctive cost-benefit analysis.
- More efficient budgetary control mechanism.
- Some entrepreneurs give emphasise on backward integration for smooth supply of input materials or services with lower chances of price fluctuations. In this situation, cost records helps to take the make or buy decision.
- Helps in determining optimum level

of stocks holding (raw-materials, stores & spares, W-I-P, finished stocks) and optimum order quantity and order cycle (EOQ). This also helps in categorising stocks in first, medium, slow and non moving items in more scientific way. The whole process ultimately resulted into release of blocked working capital.

- Distinctive information about each single products/services gives flexibility to the organisation for change in its ultimate products/services offerings as and when required based on costbenefit analysis for each single products/ services.
- Ensures the plant always runs in optimum capacity resulted in reduced fixed cost per unit of production/ service.
- Helps in quoting right price for bidding to grab any order so that desired level of margin canmaintained.
- Helps in corporate tax planning of an entity by properly budgeting each activity in monetary terms.
- Helps in assessing fair value, transfer pricing etc.
- Helps in determining the optimum frequency of preventive maintenance resulting in reduced breakdown with stable productivity and lower investment in replacing capital assets. It should be noted here that there are other several benefits apart from the above but all such, including the above-motioned benefits, depends upon effective functioning of cost records mechanism.



- It seems that the major benefits of cost records are for large organisations. What benefits does it serve to the small enterprises? All the benefits of maintaining cost records are always generic in nature. In other words, a small enterprise would get the same benefits as of a big one by maintaining cost records effectively. The benefits only depend on how rigorously the cost records are being maintained and utilised and not on the volume of an organisation. Generally, for SME enterprises the availability of funds also remain limited as compared to a big firm. Therefore, a SME organisation shall have to be comparatively more conscious for any business activity involving funds outlay. Due to this sensitivity, the cost records shall be necessary for them. At the same time the SME sectors normally have comparatively lower complexities in business transactions and the overall volume of all such transactions are also remain comparatively lesser. Therefore, it is generally more feasible for them to start the maintenance of cost records with manual efforts using spreadsheets like versatile tools at first step and continue with the same procedure and then go for fully automated ERP based solution at any future dates when the business activity permits.

- Okay, I would start maintaining cost records for my own benefits like control on costs, optimum utilisation of resources, strengthening internal MIS reporting structure and so on. But why should I require to get such cost records audited when I don't want to share my sensitive cost information to anyone? What is the benefit of cost audit to me as an entrepreneur or business leader? Maintenance of cost records and audit of cost records are two inter-related but different things. The benefits to an organisation mainly associated with effective maintenance of cost records. Under the revised

2011 cost audit Rules, there are two potential benefits that an organisation uses to get from cost audit. The first one is from its assurance part and the second one is from its new future looking concept viz. Performance Appraisal Report. Through the first benefit of cost audit, an organisation's management gets an assurance from an independent external professional (i.e. the cost auditor) that whether the cost records so maintained by the organisation are free from material errors/manipulations and are maintained in accordance with generally accepted cost accounting principles and cost accounting standards. As the cost records are intended to serve for key decisionmaking by the management, therefore this assurance plays a very crucial role to protect the wholesome objectives of cost records maintained by an organisation and thus protecting the interest of an organisation. The maintenance of cost records as per cost accounting standards is very important from the viewpoint of intra-firm comparability and sustenance of cost measurement policy. As the cost accounting standards are principle based rather rule based, they easily get fit with the present complex and flexible business models. It should also be noted here that the 2011 cost Rules also provided due shield against leakage of individual product/service related sensitive cost information by inventing the concept of product or activity group based reporting in the cost audit report. By the same, now the cost information of several products/services falling under defined groups are getting clubbed and all such clubbed information under different groups are being reported distinctively making it next to impossible to get individual product/service based cost information. The usefulness of Performance Appraisal Report is discussed in subsequent point. Apart from the above, the cost audit report serves a great importance towards government, regulators and different



independent statutory authorities by providing useful indications in terms of judging the different industry heaths, ensuring fair corporate practices and corporate governance, controlling fiscal deficits, detecting revenue leakages, controlling inflation of essential commodities, counter measurement against anti-dumping etc. Besides, above, the government, regulators and other independent statutory authorities also use the cost audit report as a basic source of information for both short term and long term economic and other policy framing. All the above ultimately influence the economy of the country and by so they have impact on functioning of each organisation.

- How Performance Appraisal Report under new cost audit mechanism can help an organisation? The Companies (Cost Audit Report) Rules, 2011 has introduced a future looking concept named as Performance Appraisal Report (PAR) as annexure to the Cost Audit Report, which is mandatory on part of Cost Auditor. The subject matters covered by the cost auditor in PAR need to be chosen depending upon the size/ scale and type of operations, nature of the industry, management requirements, etc.

This gives an unique scope to an organisation to have a third eye view by an independent professional in any matter concerning to the organisation. As there is no specific report format proposed or no limitation on scope/ coverage, this PAR gives true flexibility to an organisation to decide on the matter based on its requirement. Due to this PAR, the new cost audit mechanism has now

gone beyond the mere post-mortem certification and assurance about proper cost information and landed itself to the wider area of Management Audit. Apart from the internal MIS reports, a company management are now will have a detailed analysis of any measurements which are impacting or are likely to impact the performances of the company. As the area covered in PAR may contain sensitive information, therefore, it is mandated that the cost auditor will submit PAR only to the management of an organisation and does not require submitting it to the government or any other authorities.

- I learnt that there is a provision for cost compliance certificate that needs to be obtained by smaller companies not coming under the purview of cost audit. Through some light on the same. What benefits does it serve to me? As a first step measure to establish general cost consciousness and promoting cost culture, it was fixed that companies with specific activities having aggregate turnover of rupees twenty crores or more or the aggregate net worth of rupees five crores or more or which are listed or in the process of listing in any stock exchange in terms of their equity or debt securities, have to maintain cost records mandatorily. Although companies falling under maintenance of mandatory cost records with aggregate turnover of rupees hundred crores or more or which are listed or in the process of listing in any stock exchange in terms of their equity or debt securities, have to get their cost records audited by independent cost auditor. However, companies belonging to certain regulated industries have to



get their cost records audited as soon as they fall under criteria for mandatory maintenance of cost records. Therefore, it was mandated that for other companies that are coming under mandatory maintenance of cost records but do not require to get cost records audited for not fulfilling any aforesaid conditions, have to file a compliance certificate (commonly referred as cost compliance certificate) annually with the central government. The purpose of the same is to ensure and encourage all companies falling under mandatory maintenance of cost records, shall maintain cost records. To avoid even nominal compliance cost for this purpose an unique feature has been added to this compliance procedure that a company can obtain the compliance certificate from its employee cost accountant or it may choose an independent practising cost accountant/firm of cost accountants for the same. The benefit to the company is virtually zero certifying expenses.

- Can anytime the mechanism of cost records and cost audit provide a distinctive viewpoint about an organisation's current position, which goes in some other direction from that of the mechanism of financial records and financial audit provide? If that happens, which one I should consider? The answer to the above question is relative. However, it can be said that for organisations with small activities (producing or offering a single of product or service), grossly the two sets of accounting are supposed to provide same direction. But for big organisations (with multiple products and/or services), there are chances that the mechanism of cost records and cost audit could provide certain distinctive viewpoints. The chances are comparatively more for organisations operating from different geographical locations with substantial inter-unit transfer of products for further processing at a different location. This may lead to

increased difference among WIP and FG valuations. There might also be situations as if an organisation has managed substantial income not directly related to its main course of operation for a certain period and due to the same has managed to report net gain even if the operational income dips. In that situation too, the mechanism of cost records and cost audit would pin-point the matter by reporting a net loss while ignoring the non-operative incomes. If an organisation faces any abnormal accident occurring in huge losses of funds and thus reporting a net loss as per financial records, which otherwise could have reported a gain had it not been faced the accident. In that case also, the mechanism of cost records and cost audit would emphasis the matter of normal efficiencies by reporting a net gain while ignoring the abnormal and non-recurring type of losses. These are the few gross points where the two sets of records could lead to other directions. If any such things happened, due to which the two sets of records are providing distinctive view-point, then also it can be said that neither one is wrong. The difference are occurring simply due to the difference of measurement methodology of income and expenses and by doing so both the records are fulfilling their distinctive objectives. The cost records and cost audit mechanism also contained a profit reconciliation statement that reconciles the profits (or loss) as per cost records with the profits (or loss) as per financial records. This statement shows a glimpse of the items of incomes and expenditure and the difference in stock valuations (WIP and FG) which leads to such difference by providing better understanding about the root causes of the difference.



Cost Audit as a tool of Cost Effectiveness

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Cost-effectiveness:

Cost-effectiveness recognizes the economically most efficient way to fulfill an objective. To identify the cost effectiveness, the cost effectiveness analysis can be used as an effective tool.

Cost-effectiveness analysis (CEA) is a decision-making assistance tool. In General sense, CEA is a simple and effective ex ante evaluation tool which compares different measures or programmes with identical objectives.

It helpsto identifywaystodirectresources to achieve more. It demonstrates not only the utility of allocating resources from ineffective to effective interventions, but also the utility of allocating resources from less to more cost-effective interventions.

Analysts can obtain a programme's Cost - Effectiveness (CE) ratio by dividing Costs by Units of Effectiveness:

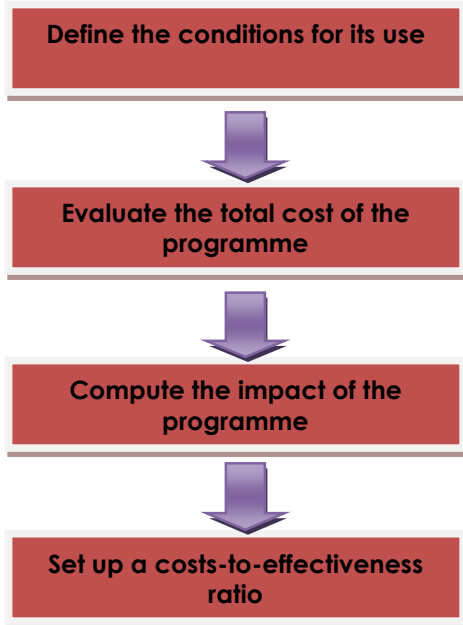
$$\text{Cost-Effectiveness Ratio} = \frac{\text{Total Cost}}{\text{Units of Effectiveness}}$$

Utility of Cost Effectiveness:

•It helps in quantifying the costs related to the project.

- It is required to assess the choices in the allocation of resources.
- It suggests whether it is preferable to invest resources in an intervention, to the detriment of another, to achieve the target.
- Instigate optimum utilization of resources to achieve the desired target.
- Enable the decision-maker determine priorities in relation to the costs and its consequences.
- An educational and communicational tool which summarizes the outcomes using a single quantifiable indicator.
- Cost-Effectiveness analyses generally include sensitivity analyses in which the input variables for assessing both cost and effectiveness are varied.
- Cost-effectiveness analysis measures project results in units rather than monetary figures.

Steps of Analyzing Cost Effectiveness:



Cost Audit:

As per ICMA London, “cost audit is the verification of the correctness of cost accounts and of the adherence to the cost accounting plan. Application of Cost Audit has several advantages for the incumbent organization and also for other interested groups. The most significant ones are enumerated below:

- Reduced costs and wastages for the organization
- Accurate and Reliable information for management and other stake holders
- Brings price competitive of products & services
- Secure greater amount of taxes and VAT for the Government
- Appropriate, adequate and just information and data for the financial analysts

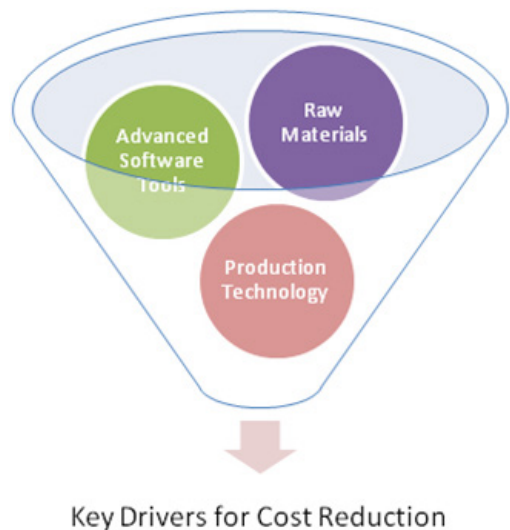
- Tools for prohibiting unethical practices in industries
- Reduced work-load and tension for the Regulatory bodies

Comparative Study:

Case-1:

A study made by the Infosys (Authors- Dr. Shama Rao N., T. G. A. Simha, Prof. K. P. Rao and Dr.Ravikumar G. V. V.) states that, Carbon Fiber Reinforced Composites are widely used in multiple industries such as, aerospace, automotive, marine, railway and oil and natural gas due to its high performance although the cost is higher compared to metals. However, recent advances in composites are driving carbon composites to be more competitive and cost effective. The reduction of defects and cycle time realized by the introduction of high-end processes is accelerating this pace further. New technological developments in fiber reinforcements, resin systems, and production concepts are continuing to drive the future deployment.

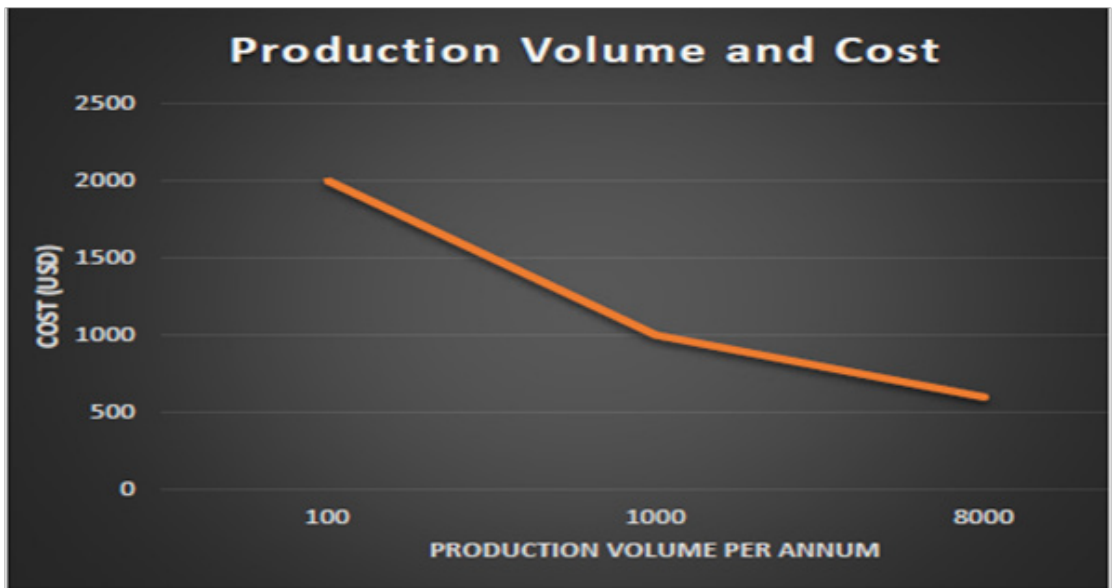
The Key Drivers of Cost Reduction





Cost Analysis:

The manufacturing cost of a composite product is highly dependent on manufacturing cost. It can be projected that total cost would show a decreasing trend with increasing volume of production in the following graph:



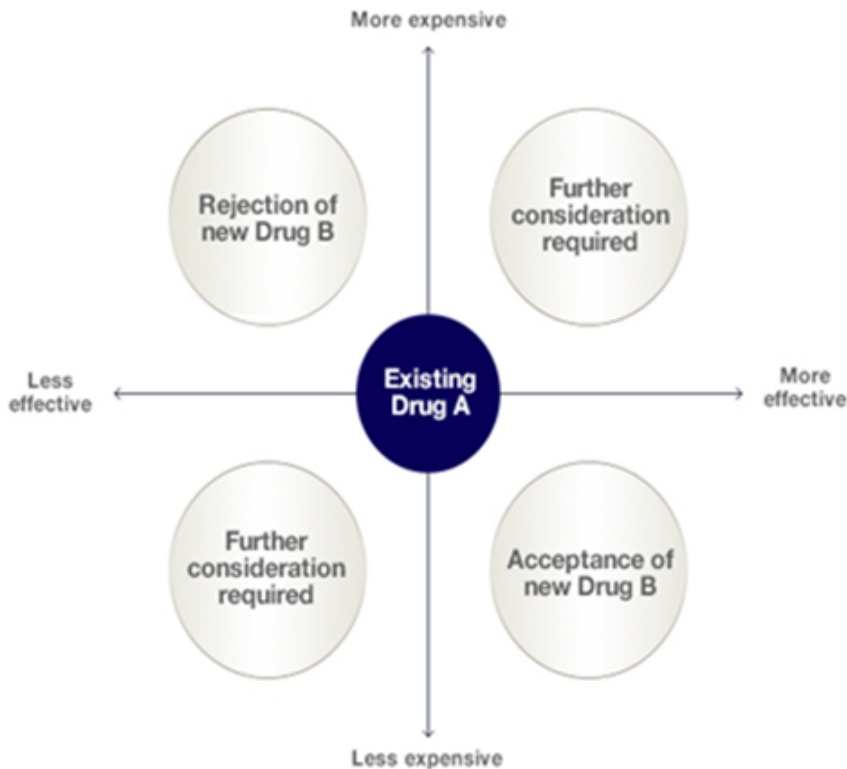
Case-2:

Pharmacoeconomics, a new concept introduced by Japan, is the science of setting a price commensurate with value. Value-based pricing demands relative assessment of both the value of the pharmaceuticals or medical devices and the related cost is the very substance of Pharmacoeconomics. True value of pharmaceuticals and medical devices can be assessed in terms of longevity and utility, and that Quality-Adjusted Life Years (QALYs) enables assessment by integrating these two factors. Long-term estimates can be made by using models (Monte Carlo Simulation Model, Markov Model, Decision Tree) and that, in relative evaluations including cost comparisons. Incremental Cost Effectiveness Ratio enables evaluation

of cost-effectiveness. While a key element of Pharmacoeconomics, models can also serve as valuable tools themselves in strategies for development and marketing. The proper output of Pharmacoeconomics is information needed for making decisions on selection of pharmaceuticals and medical devices as viewed from the standpoint of cost-effectiveness, the techniques are applicable in a diversity of domains. For example, consider the case of assessment of new drug B compared with existing drug A for a certain disease. If drug B has a lower total cost (meaning not only the pharmaceutical cost but also all related costs generated over the long term) and higher QALYs than drug A, it is easy to reach a conclusion - drug B is the obvious preference. Decisions become

more difficult when drug B entails a higher total cost but also affords a higher QALYs than drug A (although the reverse situation, i.e., a lower total cost but also a lower QALYs, is also possible, but we omit it because delivery of an equivalent or higher QALYs by the new drug would be the more realistic premise). In other words, drug B would be more effective (QALYs) than drug A, but also carry a proportionately higher expense.

Cost – Effectiveness Matrix



Cost-Effectiveness and Cost Audit:

The main objective of cost-effectiveness is to minimize cost and ensure optimum utilization of resources. Here the cost audit can play a big role to fulfill the objective of cost-effectiveness. The objective of cost audit is to verify the cost of manufacture or services, on the basis of accounts as regards utilization of material or labour or other items of costs, maintained by the company.

Therefore the objective of cost-effectiveness and cost audit is quite similar. The cost audit can act as a driver to bring cost effectiveness

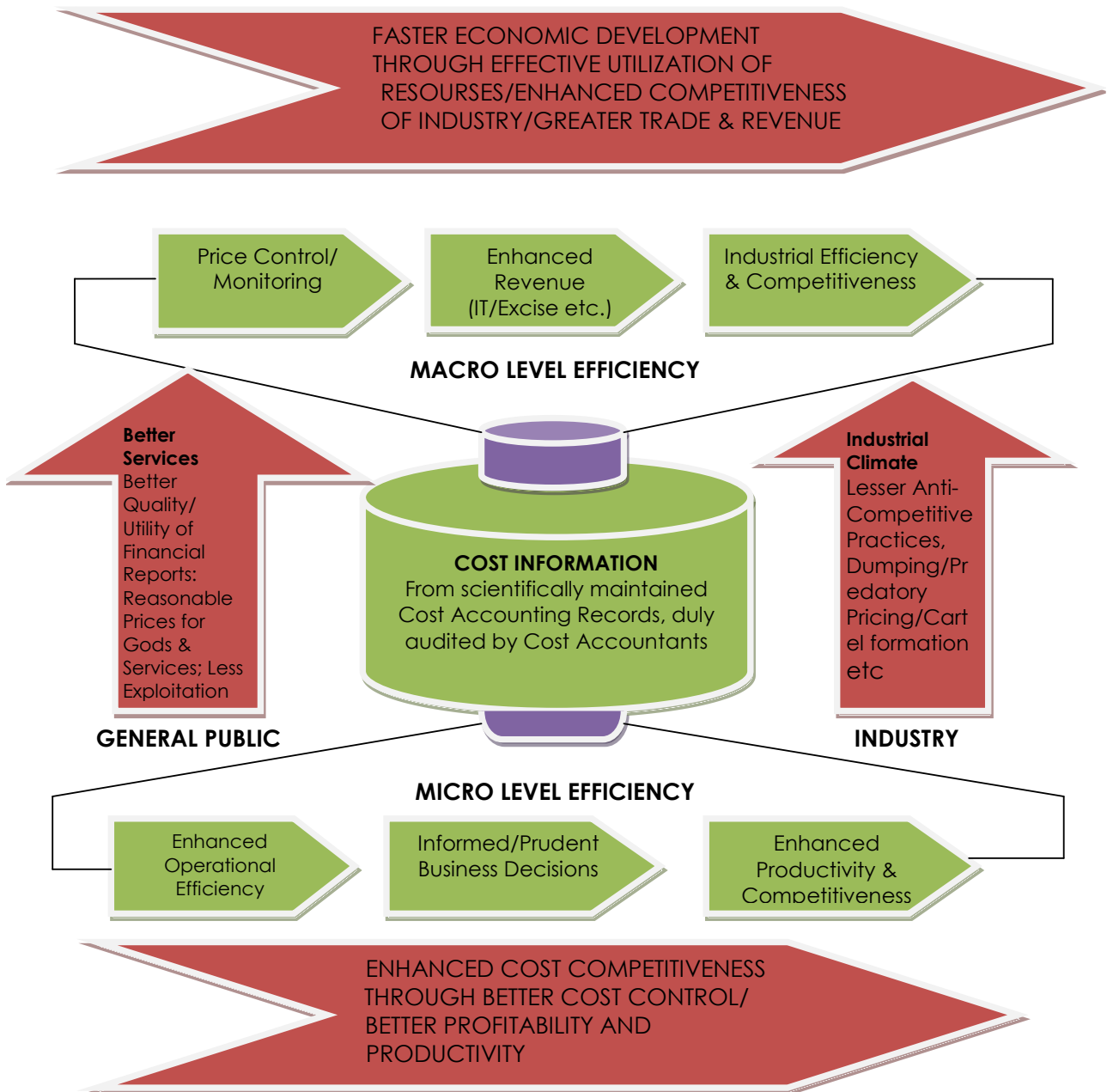
and decision making in the following way:

- The Performance Appraisal Report given by the Cost Auditor to the company contains very useful information and suggestions on various areas: e.g. capacity utilization, efficiency analysis, Utilities analysis, Key-costs and Contribution analysis, etc. Moreover, the report goes only to the company, and therefore, the fear of the industry sharing it with the government has been done away with. Companies can reap huge benefits from this report which is based on the experience and expertise of the cost auditor.



- Para 4 'Quantitative Information' of the annexure to the Cost Audit Report gives very useful information on capacity utilization and indicates idle capacity.
 - Para 5 'Abridged Cost Statement' and Para 6 'Operating Ratio Analysis' provide valuable inputs to the company indicating element-wise cost compared with previous year and operational efficiency at each cost element.
 - Para 7 'Profit Reconciliation' may throw light on some typical areas; for example, there is a profit as per the Financial Accounts but there may be loss as per the Cost Accounts.
 - Cost audit detects errors, frauds and misappropriations and hence enhance cost effectiveness.
 - Para 9 'Financial Position and Ratio Analysis' can give information about stock value and working capital management which help in bringing cost effectiveness in an organization.
 - Para 10 'Related Party Transactions' and Para 4 'Quantitative Information' which gives information on Capacity Utilization and Captive Consumption can provide good input.
- Proper cost auditing ensure efficiency in the use of resources, promotes cost effectiveness of the individual industry. Therefore, Cost Audit is not solution in itself but also a tool for bringing cost effectiveness.

Utility of Cost Audit

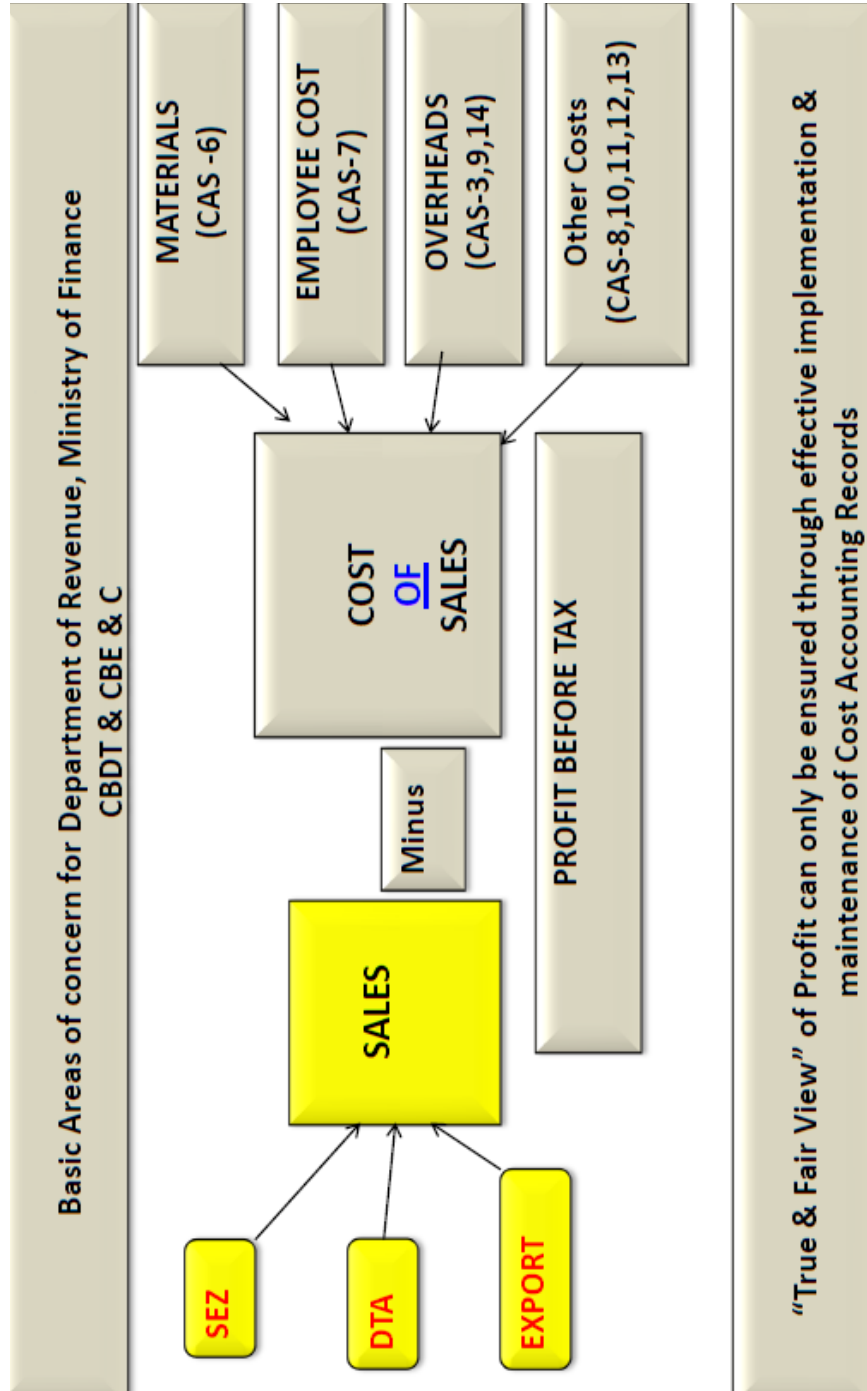


Reference:

1. www.ncbi.nim.gov, 2. www.ec.europa.eu, 3. www.learningsolutionmag.com, 4. The Management Accountant of ICAI (CMA), 5. Carbon Composites Are Becoming Competitive and Cost Effective- Dr. Shama Rao N., T. G. A. Simha, Prof. K. P. Rao and Dr. Ravi Kumar, G. V. V. - Infosys Ltd., 6. Website- http://www.crecon.co.jp/pharmaco_english/essence/

Linkage between Cost Record & Cost Audit through major elements of Cost

From the Institute's Desk



Profit & Loss Account for the year ended 31.3.xxxx

To Value of inventory at the beginning	xxxxx	By Accrual or Receipt from Business (Income from Operations = Sales)	Xxxxxx
To Operating Expenses (Cl.35)	xxxxx	By Value of any benefit of perquisite	Xxxxxx
To Finance Charges (Cl.36)	xxxxx	By Value of inventory at the closing	Xxxxxx
To Capital Allowance (Cl.37)	xxxxx	By any amount received from a business after its discontinuance (AS-24 and Sec.172 of the IT Act,1961)	Xxxxxx
To Balance c/d (Net Profit for the year as per P & L A/c)	xxxxxx	By Carbon Credits	Xxxxxx
	Xxxxxxx		Xxxxxx

Reconciliation:

Sales as per Profit & Loss A/c (i.e. Income Tax Return) = Sales as per (VAT + CST + EXPORT + Exempted Sales) = Sales as per Central Excise Return

Reverse Engineering : From Returns to Profit & Loss Account

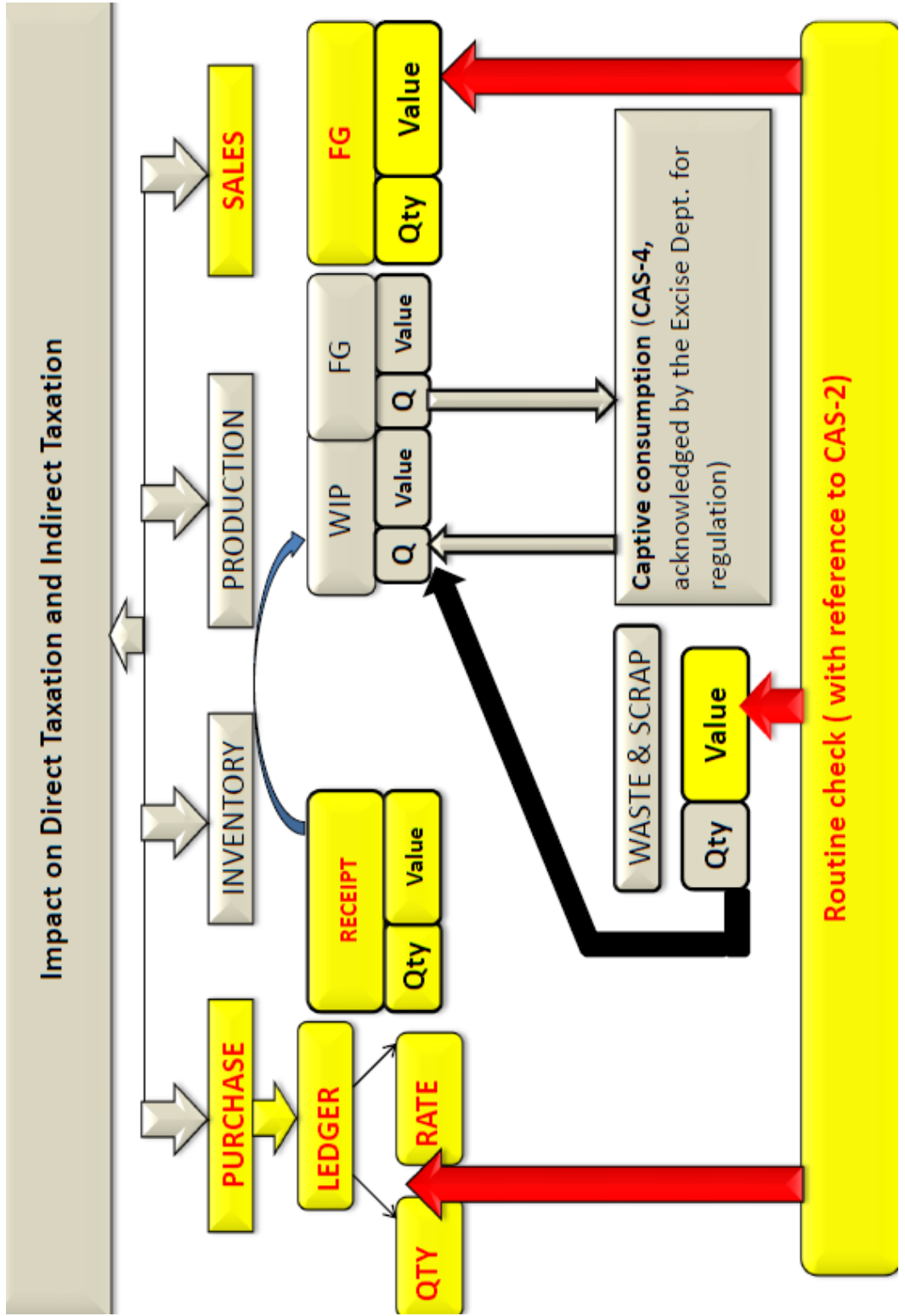
Reconciliation:

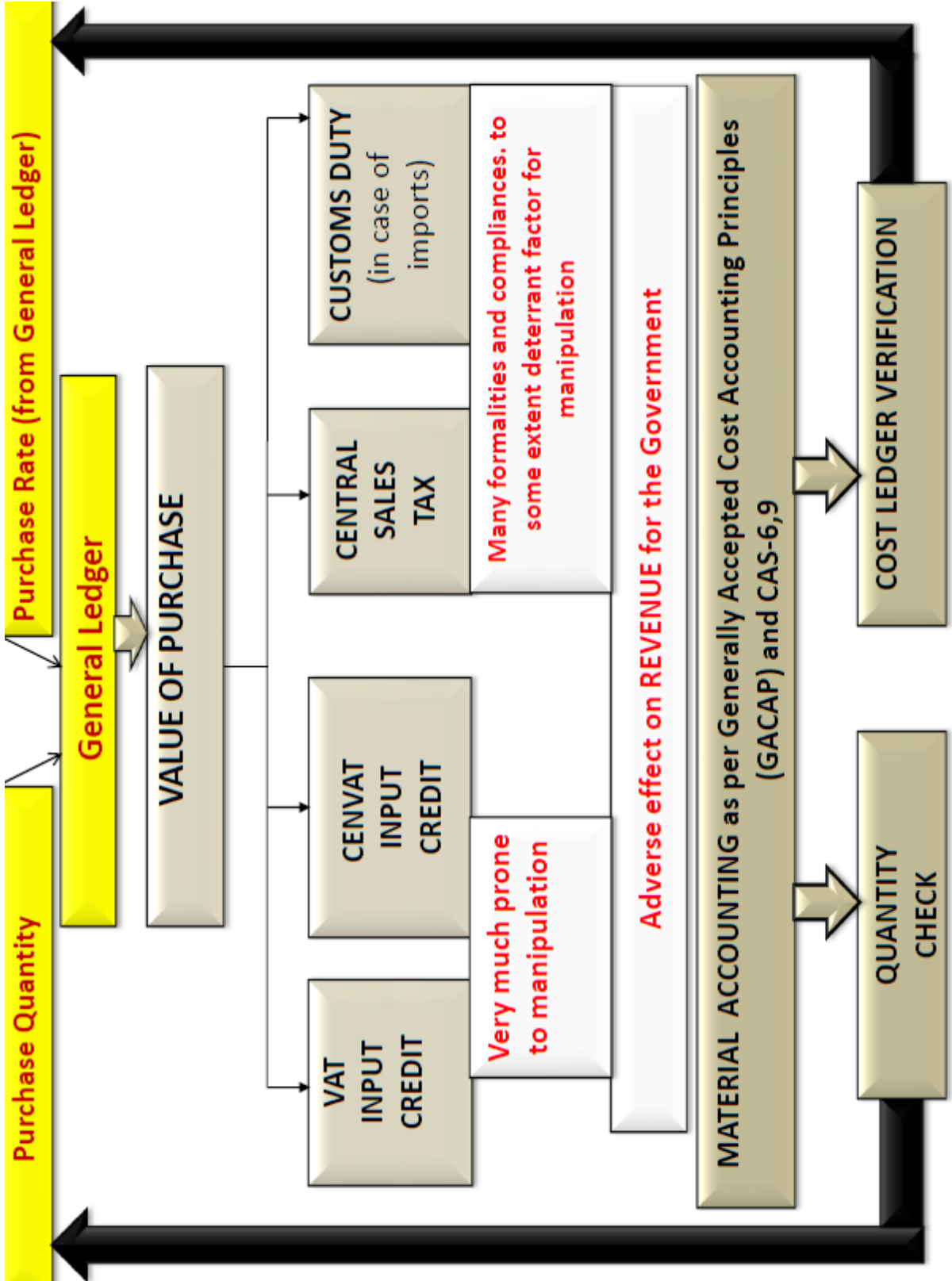
Sales as per Profit & Loss A/c (i.e. Income Tax Return)

= Sales as per (VAT + CST + EXPORT + Exempted Sales)

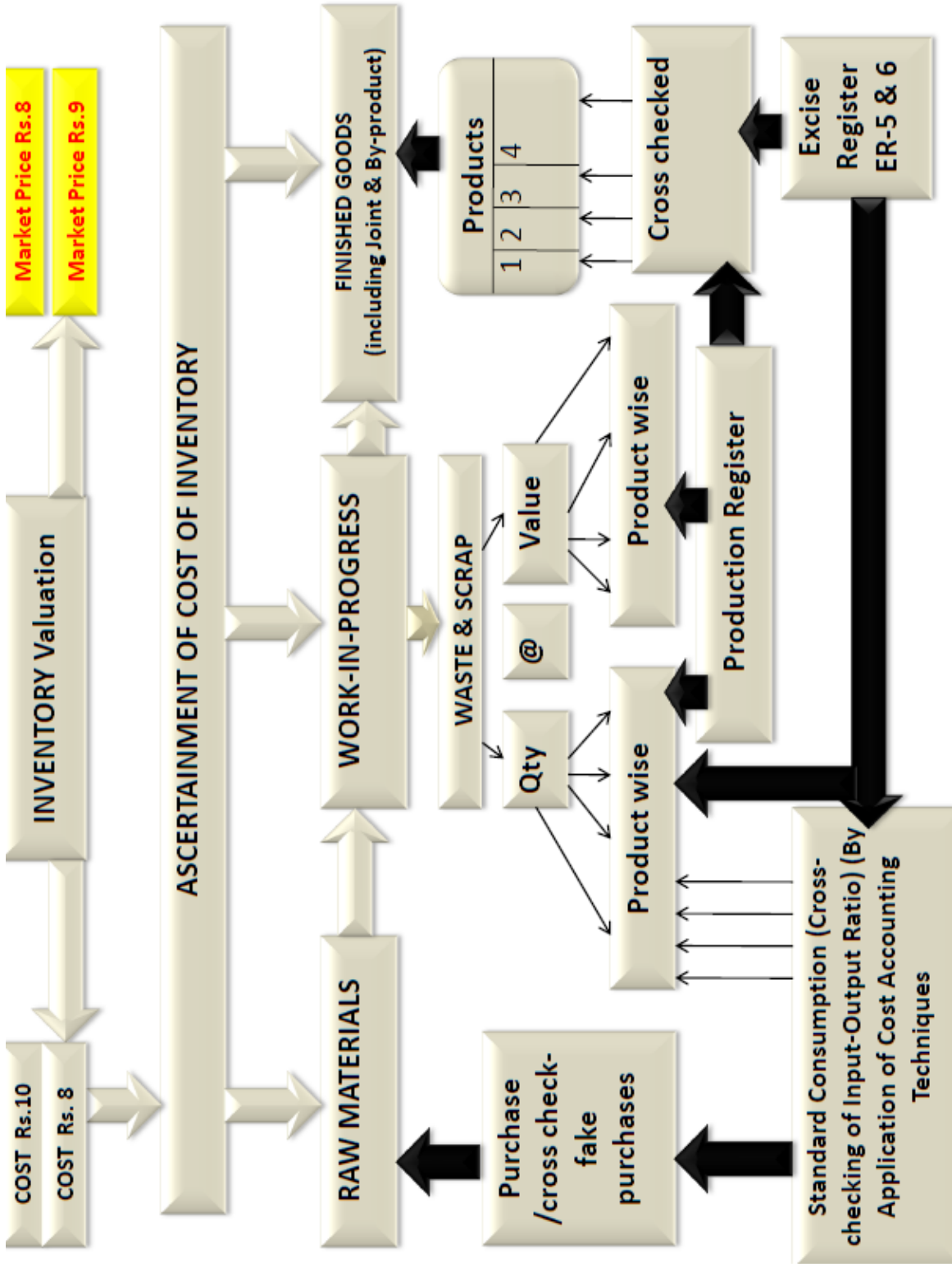
= Sales as per Central Excise Return

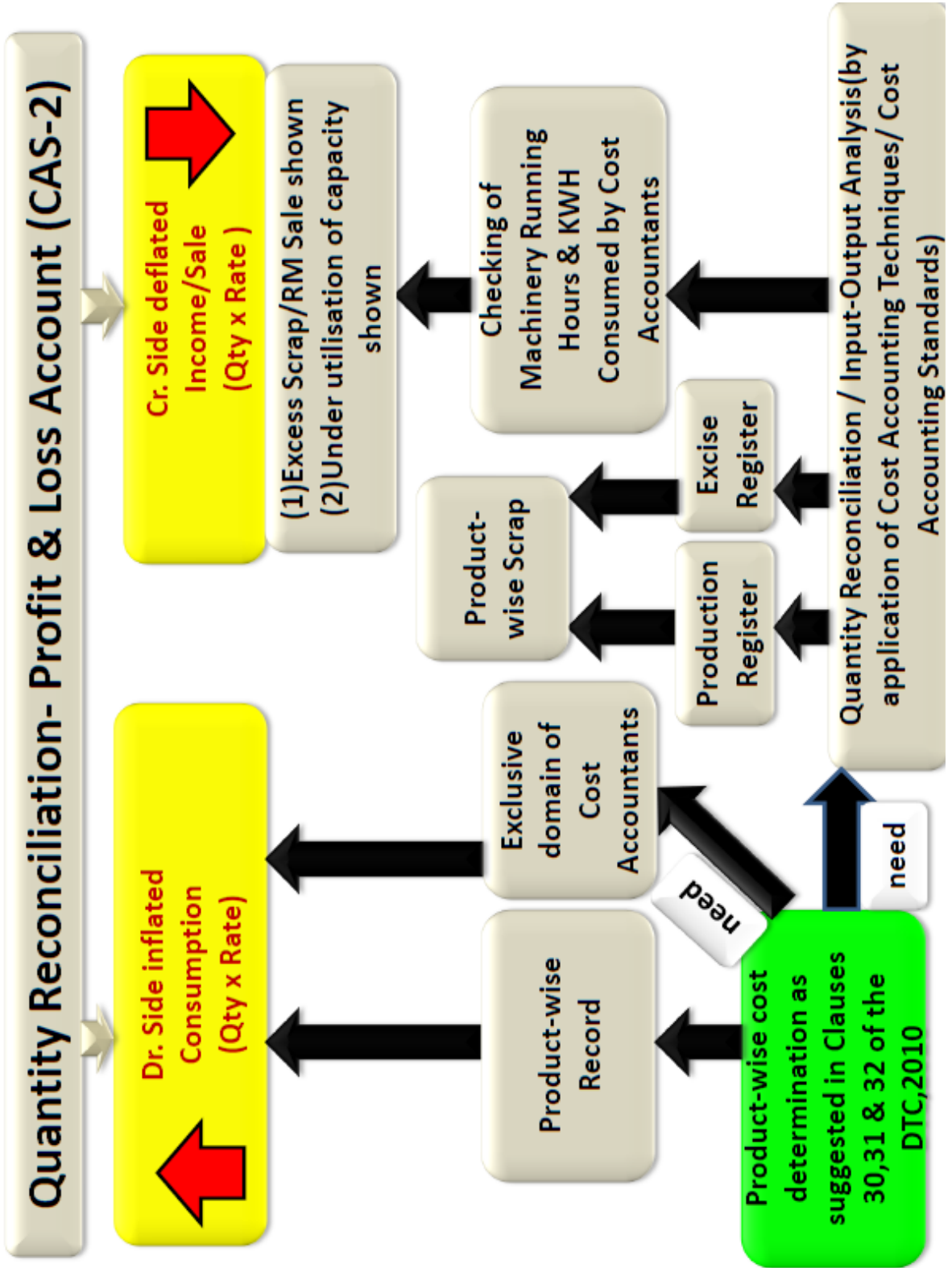
Cost Effectiveness through Cost Audit



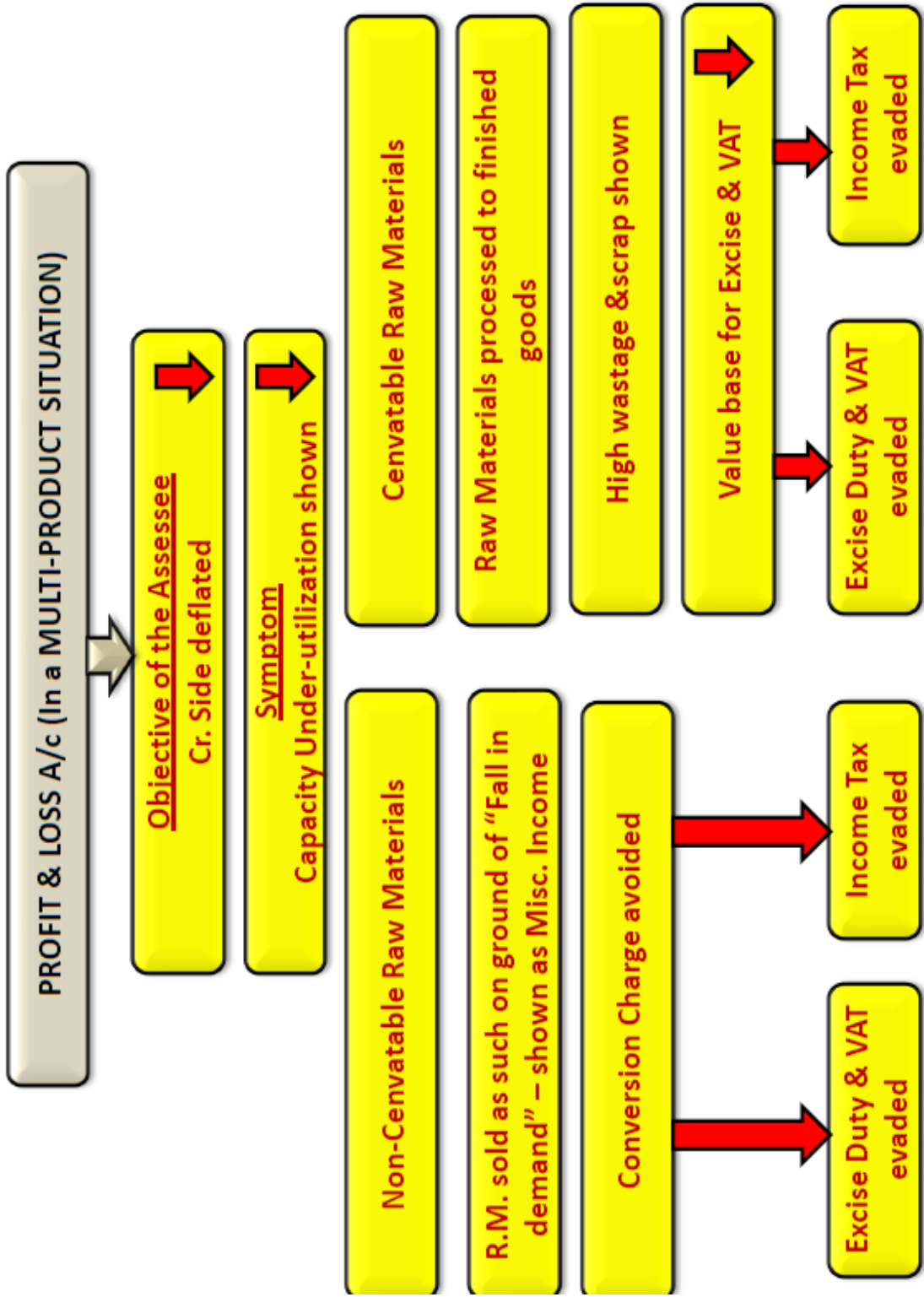


Cost Effectiveness through Cost Audit

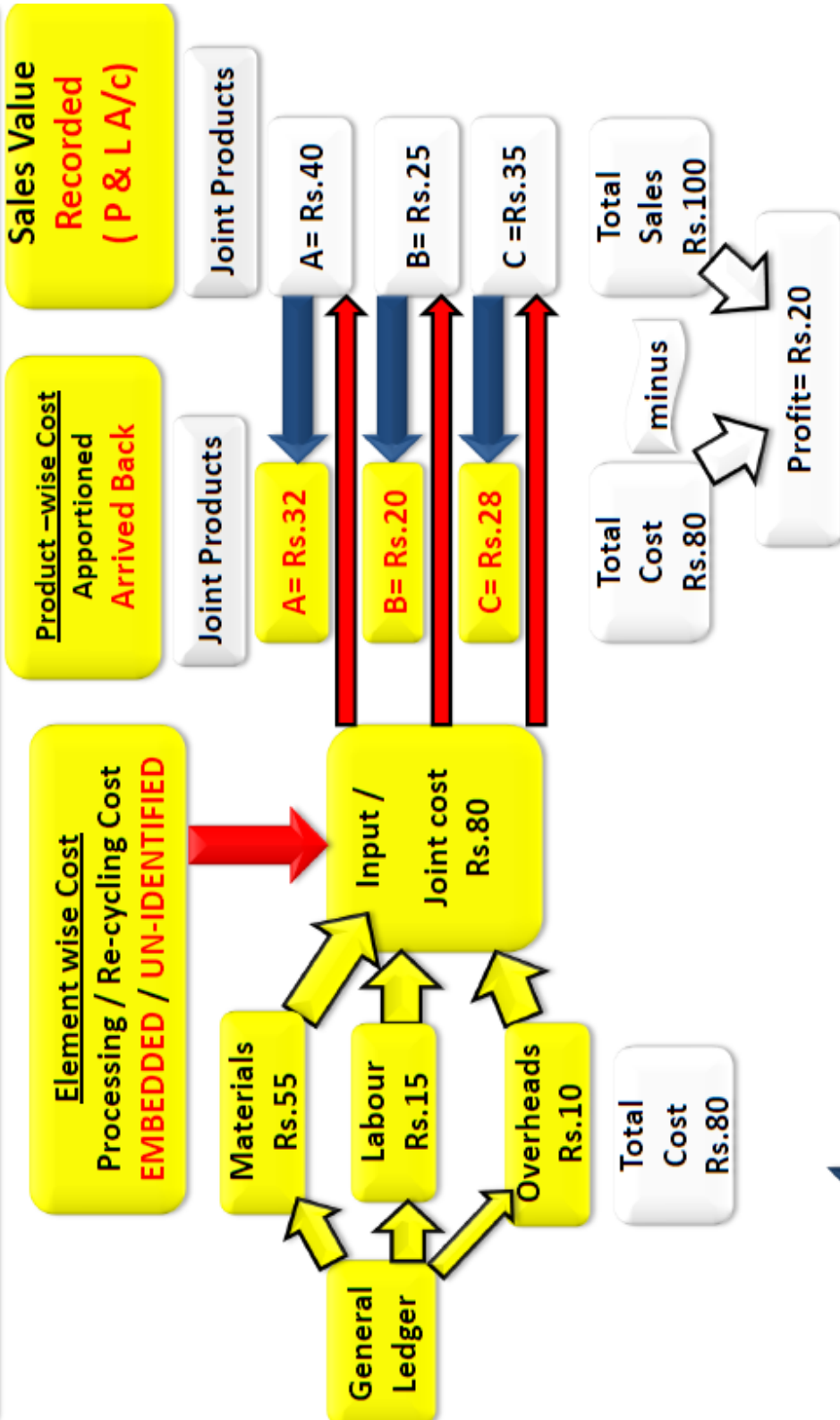




Cost Effectiveness through Cost Audit



Impact on Direct Taxation in multi/joint & by-product situation (As per Financial Records)



Backward process of apportionment of Joint Cost

Cost Effectiveness through Cost Audit



Tax sought to be evaded as revealed from Cost Records

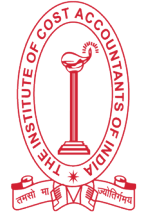
Materials	Cost (excl. Process Cost)(Rs.)	Process Cost (Rs.)	Total Cost (Rs.)	Total Sale Value (Rs.)	Profit as per Finance (Rs.)	Fake Purchases treated as Abnormal Loss (Rs.)	Profit as per Cost Records (Rs.)
Materials							
(a) Input	45	3	55	80			
(b) Normal Loss	2						
(c) Abn. Loss	5						
Controllable - Cost treated as Abnormal Loss/Waste/Scrap							
				100	20	5	25
Labour	14	1	15				
Overheads	9	1	10				
Total	75	5	80				
Understatement of Profit (1)							
5.00	Income Tax @ 30% evaded (2)			VAT payment @ 14.5% on fake purchases embraced	Net Evasion (4= 2-3)	Net Evasion (as a % on Understated Profit)	
	1.50	0.725	0.775	15.5%			

Reverse Engineering: Output to Input Analysis

Particulars	Shown by Assessee			Output to Input Analysis		
	RM	WIP	FG	RM	WIP	FG
Opening Stock	2	2	4	2	2	4
Add: Purchases/Introduced	8 <i>(shown in P&L A/c)</i>	6	3	5	3 <i>(Bal.fig.)</i>	3
	10	8	7	7	5	7
Less: Handling Loss/Waste	(1)	(4)	(---)	(1)	(1)	(---)
	9	4	7	6	4	7
Less: Closing Stock	3	1	2	3	1	2
Transfer to Next Stage/Sale	6	3	5	3	3	5

The Institute of Cost Accountants of India

(Statutory body under an Act of Parliament)



The Institute of Cost Accountants of India is a statutory body set up under an Act of Parliament in the year 1959. The Institute, as a part of its obligations, regulates the profession of Cost and Management Accountancy, enrolls students for its courses, provides coaching facilities to students, organises professional development programmes for members and undertakes research in the field of Cost and Management Accountancy. The Institute pursues the vision of cost competitiveness, cost management, efficient use of resources and a structured approach to cost accounting as the key drivers of the profession. In today's world, the profession of conventional accounting and auditing has taken a back seat and cost and management accountants are increasingly contributing to the management of scarce resources like funds and land and take decisions that are strategic in nature. This has given cost accountants in India and abroad further scope and tremendous opportunities.

After an amendment passed by Indian Parliament, the institute was renamed as 'The Institute of Cost Accountants of India' from 'The Institute of Cost and Works Accountants of India'. This was aimed at synergising with global management accounting bodies and sharing best practices. It was also useful to a large number of trans-national Indian companies operating from India and abroad to remain competitive. With the current emphasis on management of resources coupled with the specialized knowledge of evaluating operating efficiency and strategic management, Cost Accountant professionals are now known as 'Cost and Management Accountants (CMAs)'. The institution operates through four regional councils in Kolkata, Delhi, Mumbai and Chennai and 95 Chapters situated in important cities in the country as well as 9 Overseas Centres. The Institute is head-quartered in Kolkata. It is under the administrative control of the Ministry of Corporate Affairs, Government of India.

The Institute, apart from being a member of the International Federation of Accountants (IFAC), South-Asian Federation of Accountants (SAFA),

Confederation of Asian & Pacific Accountants (CAPA), National Advisory Committee on Accounting Standards (NACAS), and National Foundation for Corporate Governance (NFCG) is also a member of the Government Accounting Standards Advisory Board (GASAB)

Vision Statement

"The Institute of Cost Accountants of India would be the preferred source of resources and professionals for the financial leadership of enterprises globally."

Mission Statement

"The CMA professionals would ethically drive enterprises globally by creating value to stakeholders in the socio-economic context through competencies drawn from the integration of strategy, management and accounting."

About ICAI-CMA

- ✓ Four Regional Councils, 95 Chapters all over India, nine Overseas Centres
- ✓ About 50,000 qualified members
- ✓ Over 5 lakh students enrolled
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- ✓ About ICAI-CMA Course
- ✓ Full-time course for students
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Role of a CMA

- ✓ Improving cost competencies
- ✓ Resource Management
- ✓ Performance Management
- ✓ Financial Reporting and Strategy
- ✓ Cost Audit and Assurance
- ✓ Cost control and Cost Reduction
- ✓ Risk management and Mitigation
- ✓ Direct and Indirect Taxation
- ✓ Valuations
- ✓ Internal Audit

C I I



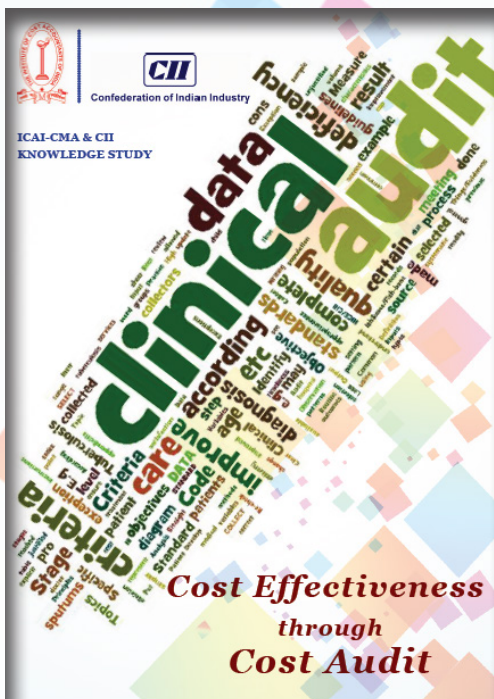
The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, Government, and civil society, through advisory and consultative processes.

Confederation of Indian Industry

CII is a non-government, not-for-profit, industry-led and industry-managed organization, playing a proactive role in India's development process. Founded in 1895, India's premier business association has over 7200 members, from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 100,000 enterprises from around 242 national and regional sectoral industry bodies. CII charts change by working closely with Government on policy issues, interfacing with thought leaders, and enhancing efficiency, competitiveness and business opportunities for industry through a range of specialized services and strategic global linkages. It also provides a platform for consensus-building and networking on key issues.

Extending its agenda beyond business, CII assists industry to identify and execute corporate citizenship programmes. Partnerships with civil society organizations carry forward corporate initiatives for integrated and inclusive development across diverse domains including affirmative action, healthcare, education, livelihood, diversity management, skill development, empowerment of women, and water, to name a few. The CII theme of 'Accelerating Growth, Creating Employment' for 2014-15 aims to strengthen a growth process that meets the aspirations of today's India. During the year, CII will specially focus on economic growth, education, skill development, manufacturing, investments, ease of doing business, export competitiveness, legal and regulatory architecture, labour law reforms and entrepreneurship as growth enablers.

With 64 offices, including 9 Centres of Excellence, in India, and 7 overseas offices in Australia, China, Egypt, France, Singapore, UK, and USA, as well as institutional partnerships with 312 counterpart organizations in 106 countries, CII serves as a reference point for Indian industry and the international business community.



Confederation of Indian Industry

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THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

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