

# Legal Update

Vinod Kothari & Company

## MCA clarification regarding applicability of cost audit records and rules-

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The last financial year can be viewed as one which was a major boost for practicing cost accountants. Where on one hand the Ministry of Corporate Affairs (“MCA”) issued Cost Audit Orders Rules relating to cost audit report and cost accounting records, on the other hand it kept issuing clarifications at regular intervals. These clarifications were like an afterthought proving industry critics right that in its drive to increase the scope of work of practicing cost accountants, the MCA has gone on an overdrive to issue circulars without as much as giving a thought on the viability of the same.

Further vindicating such critics, the MCA has come up with two more circulars in the form of clarifications:

1. General Circular 11/2012<sup>1</sup> dated May 25, 2012 (“Circular 1”) about coverage of certain sectors by cost accounting records and cost audit.
2. General Circular 12/2012<sup>2</sup> dated June 04, 2012 (“Circular 2”) about mandatory cost audit for certain companies.

### Circular 1

With Circular 1, MCA has partially amended General Circular vide 67/2011<sup>3</sup> dated November 30, 2011 whereby it had prescribed non-applicability of Cost Audit Orders to *inter alia* 100% Export Oriented Units (“EOU”).

With Circular 1, the requirement for cost audit of all units has been dropped for units located in specified zones like:

- Special Economic Zone (“SEZ”)
- EOU  
Free Trade Zones (FTZs)
- Export Processing Zones (EPZs)

However, this is subject to the following conditions:

1. The exemption from cost audit is only for the units of companies located either in the specified zones or qualify as 100% EOUs. However, on the same note the exemption is **not** for all other units of the same company.  
Circular 1 is thus clear in its intent that such an advantage can only be enjoyed by such units which are located in any of the specified zones in addition to the various tax sops already enjoyed by such units.

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<sup>1</sup> [http://www.mca.gov.in/Ministry/pdf/General\\_Circular\\_No\\_11\\_2012.pdf](http://www.mca.gov.in/Ministry/pdf/General_Circular_No_11_2012.pdf)

<sup>2</sup> [http://www.mca.gov.in/Ministry/pdf/General\\_Circular\\_No\\_12\\_2012.pdf](http://www.mca.gov.in/Ministry/pdf/General_Circular_No_12_2012.pdf)

<sup>3</sup> [http://mca.gov.in/Ministry/pdf/General\\_Circular\\_No\\_67\\_2011.pdf](http://mca.gov.in/Ministry/pdf/General_Circular_No_67_2011.pdf)

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However, in case any statutory body requires, such units would also be subject to conduct cost audit in accordance with extant Rules/Orders.

This exemption would also not be made available if the unit of the company moves out of the specified zones or loses 100% EOU status. In such a case, the unit would be required to get cost audit done from the year in which the change was effected and for every subsequent year thereafter.

2. To save the company from any major discomfort in case of any inspection, the MCA has prescribed such relevant units to maintain cost audit records and file compliance report with the MCA in accordance with the applicable Companies (Cost Accounting Records) Rules, 2011.

Thus, on the face of it, Circular 1 seems to narrow the scope of cost accountants, however, companies would still need to appoint practicing cost accountants for the purpose of maintenance of records and filing of compliance report annually. Other compliances like placing the same in front of the Audit Committee and Board will also accordingly apply.

3. Further, in case of any sale from such specified zones to Domestic Tariff Areas (“DTAs”), if the amount of sales exceeds the permissible limits for any year, then the exemption from cost audit shall stand withdrawn and that unit shall be required to get its cost accounts audited starting from the year in which the exemption is withdrawn and for every subsequent year.

The inclusion of the phrase “*for every subsequent year thereafter*” has given rise to the ambiguity that in case from any subsequent year sales to DTAs are again within the permissible limits, would the unit still be required to get cost audit done?

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### Circular 2

With Circular 2, MCA has come up with further clarifications on its Order vide no. 52/26/CAB-2010 dated May 2, 2011 ("Order 1") whereby:

1. For companies whose products/ activities are already covered by the Rules and meet with the threshold limits given in Order 1, the provisions of Order 1 shall apply in respect of each FY commencing from April 01, 2011.  
Although Order 1 seems to have a retrospective effect and some may feel that the clarification has come a tad late (Circular 3 requires cost auditor to be appointed within 90 days of beginning of financial year), such companies still have the time to pull up their socks and comply with the requirements of Circular 3.
2. For companies whose products/ activities are covered by Rules specified in Annexure-2 and meet with the threshold limits, provisions of Order 1 shall be applicable in respect of each FY commencing on or after December 07, 2011 i.e. from FY 2012-13 (including calendar year 2012) onwards.

Essentially, companies whose products/ services are covered by Rules specified in Annexure-2 were only required to maintain cost audit records. With Circular 3 such companies are also required to get their cost accounts audited.

3. Further clarification is also provided that in case of companies engaged in production, processing, manufacturing or mining of multiple products/activities:
  - i. If any of their products/activities are not covered under the industry specific Cost Accounting Records Rules, but are covered under the Companies (Cost Accounting Records) Rules, 2011 notified vide GSR 429(E) dated June 3, 2011 **and**
  - ii. Wherein such products/activities are not covered under cost audit vide cost audit orders dated June 30, 2011 and January 24, 2012,

such companies will be required to follow provisions of General Circular No. 68/2011 dated November 30, 2011 i.e. file compliance report as per Form-B and in case the cost accounting records and rules are applicable only for the first time then, maintain the cost records and cost details, statements, schedules in good condition for eight years.

With such clarifications regarding the applicability of cost audit orders and cost audit rules, it is clear that the industry is closely watching the initiatives of MCA in this regard and also actively participating in the same.

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For a complete analysis of all the Rules, Circulars and Orders issued, apart from the ones discussed above, please refer the following link:

[http://india-financing.com/note\\_on\\_cost\\_auditor\\_read\\_with\\_cost\\_rules\\_and\\_order.pdf](http://india-financing.com/note_on_cost_auditor_read_with_cost_rules_and_order.pdf)