

# 2013



## The Pakistan Business Council

### Research Unit

**[Comparative analysis of COMPANIES (AUDIT OF COST ACCOUNTS) RULES, 1998 with prevailing legislation in India, Bangladesh and 10 Other countries.]**

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## **Executive Summary:**

The Securities and Exchange Commission Pakistan (SECP) is the primary regulator of the corporate sector of Pakistan and its responsibility is to develop a modern and efficient business environment conducive to the growth and prosperity of the concerned organizations. That being said, it is also the responsibility of the SECP to devise rules that are fair and progressive which encourage economic growth.

In a review of 13 jurisdictions, it appears that Mandatory Cost Audit only exists in Pakistan, India and Bangladesh having been included in the Companies Ordinances of the respective countries. In Pakistan there 9 industries that fall under the specific stipulations of this law. Statutory Audits have evolved over time into in-depth analysis of the company's operations; hence Cost Audits are a duplication of work as most procedures are the same.

It is observed that although the prevailing laws in all three jurisdictions are similar, India being the first country to implement mandatory Cost audit, it has the most comprehensive laws and it covers a larger number of sectors.

Cost audits require access to information regarding processes and other confidential data the disclosure of which could adversely affect a firm's competitive advantage if it is leaked out.

Local and foreign investment has drastically fallen in Pakistan over the last few years and measures like Compulsory Cost Audit are seen by investors as a serious negative. In view of the prevailing practices in other successful economies, it is advisable that Mandatory Cost Audits be removed from legislation as it is unnecessarily intrusive and increases the cost of doing business.



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Serial No.	Section	Pakistan [Companies (Audit of Cost Accounts) Rules, 1998.]	India [The Companies (Cost Audit Report) Rules, 2011]	Bangladesh [Cost Audit (Report) Rules 1997]	10 Other Countries	Comments
1	<b>Short title, Application and Commencement</b>	<p>i. These rules may be called the Companies (Audit of Cost Accounts) Rules, 1998.</p> <p>ii. These rules shall apply to companies or class of companies, which are required by the Corporate Law Authority through a general or special order issued under clause (e) of sub-section (1) of section 230 of the Companies Ordinance, 1984, to include in their books of account, such particulars relating to utilization of material or labor or to other inputs or items of cost, as specified in that order.</p>	<p>(1) These rules may be called The Companies (Cost Audit Report) Rules, 2011. (2) They shall come into force on the date of their publication in the Official Gazette.</p>	<p>These rules may be called the “Cost Audit (Report) Rules, 1997”.</p>	<p><b>US:</b> The United States has laws regarding Cost Audit they are called the Cost Accounting Standards(CAS) they are only mandatory on Government contractors but they are exempt under certain conditions:</p> <ul style="list-style-type: none"> <li>• Contracts awarded to small businesses are exempt from CAS, regardless of contract size</li> <li>• Any contract less than US\$7.5 million is exempt, provided the company has not been awarded a contract greater than US\$7.5 million, and also any contract less than US\$700,000 is always exempt</li> <li>• Contracts for commercial items</li> </ul>	

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		iii. They shall come into force at once.			<ul style="list-style-type: none"> <li>• Contracts awarded under sealed bid procedures, or where "adequate price competition" was available (the latter meaning where at least two companies had the ability to bid and perform on a contract, even if only one bid was later received)</li> <li>• Contracts where the price is set by law or regulation</li> <li>• Contracts awarded to foreign governments</li> <li>• Contracts awarded to foreign concerns (only the disclosure statement and CAS 401 and 402 apply in this case)</li> </ul>	

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2	Definitions	<p>In this rules, unless there is anything repugnant in the subject or context,-</p> <p>i. "Appendix" means an Appendix to these rules;</p> <p>ii. "company" means a company formed and registered under the Companies Ordinance, 1984 (XLVII of 1984), and to which these rules apply;</p> <p>iii. "director" means a director of a company; and</p> <p>iv. "cost auditor" means a cost auditor appointed under rule 3.</p>	<p>In these rules, unless otherwise so provided,-</p> <p>-- (a) "Act" means the Companies Act, 1956 (1 of 1956);</p> <p>(b) "Cost Auditor" means an auditor appointed to conduct an audit of cost records, under sub-section (2) of section 233B of the Act;</p> <p>(c) "Form-I" means the Form prescribed in these rules for filing cost audit report and other documents with the Central Government in the electronic mode;</p> <p>(d) "Form-II" means the Form of the cost auditor's report and includes auditor's observations and suggestions, and Annexure to the cost audit report;</p> <p>(e) "Form-III" means</p>	<p>(1) Unless there is anything repugnant to the subject or context, in these rules-</p> <p>(a) "Act" means the Companies Act, 1994 (Act No. XVIII of 1994);</p> <p>(b) "Employee" means all the employees including the officers;</p> <p>(c) "Cost Auditor" means "Cost and Management Accountant" as defined in the Cost and Management Accountants Ordinance, 1977 (Ordinance No. LIII of 1977), herein after called the "said Ordinance: and any Cost Audit firm also included in it;</p> <p>(d) "Company" means a company engaged in production, distribution, marketing, transportation, processing,</p>	<p><b>UK:</b> No Statutory Cost Audit Requirements.</p> <p><b>Canada:</b> No Statutory Cost Audit Requirements.</p> <p><b>Australia:</b> No Statutory Cost Audit Requirements.</p> <p><b>South Africa:</b> No Statutory Cost Audit Requirements.</p> <p><b>Indonesia:</b> No Statutory Cost Audit Requirements.</p> <p><b>Thailand:</b> No Statutory Cost Audit Requirements.</p> <p><b>Singapore:</b></p>	

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			<p>the Form of the performance appraisal report;</p> <p>(f) “Product” means any tangible or intangible good, material, substance, article, idea, know-how, method, information, object, service, etc. that is the result of human, mechanical, industrial, chemical, or natural act, process, procedure, function, operation, technique, or treatment and is intended for use, consumption, sale, transport, store, delivery or disposal.</p> <p>(g) “Product Group” in relation to tangible products means a group of homogenous and alike products, produced from same</p>	<p>manufacturing, milling or extraction and mining activities;</p> <p>(e) “Section” means any section of the “Companies Act, 1994 ( Act No. XVIII of 1994).</p> <p>(2) All other words used in these rules but not defined shall have the same meaning as assigned to them in the “Companies Act, 1994 (Act No. XVIII of 1994)”.</p>	<p>No Statutory Cost Audit Requirements.</p> <p><b>Malaysia:</b> No Statutory Cost Audit Requirements.</p> <p><b>Turkey:</b> Tax Procedure Law, 1949 when it became obligatory to keep a manufacture book for industrial enterprises. However; in the year 1994 when The Communiqués introduced by Ministry Of Finance came into practice, the usage of the manufacture book decreased. As the enterprises using the 7/A option stated in this communiqués, can escape from the obligation of keeping a manufacture book if they are able to watch their amount movements in their accounting systems. On the other hand the users of 7/A</p>	

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			raw materials and by using similar or same production process, having similar physical or chemical characteristics and common unit of measurement, and having same or similar usage or application; and in relation to intangible products means a group of homogenous and alike products or services, produced by using similar or same process or inputs, having similar characteristics and common unit of measurement, and having same or similar usage or application; (h) "Report" means cost audit report duly audited and signed by the cost auditor in the prescribed form of cost		and 7/B the obligation of keeping a manufacture book is still going on. However, there is a decrease in its importance because of the accounting systems and developments of computer programs.	

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			audit report;  (i) All other words and expressions used in these rules but not defined, and defined in the Act and rules made under clause (d) of sub-section (1) of section 209 and sub-section (4) of section 233B of the Act shall have the same meanings as assigned to them in the Act or rules, as the case may be.			
3	<b>Appointment of Cost auditors</b>	i. Every company shall be required to get its cost accounts audited by a cost auditor who is a Chartered Accountant within the meaning of the Chartered	Not Mentioned.	<b>Section 5.-(1)</b> The board of directors of a Company ordered to have its books of accounts audited as such by the Government under section 220 (1), shall appoint a cost auditor fixing his		The approval of the Cost Auditor has to be taken from the corporate law authority this may result in delays causing the companies

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		<p>Accountants Ordinance, 1961 (X of 1961), or a Cost and Management Accountant within the meaning of the Cost and Management Accountants Act, 1966 (XIV of 1966).</p> <p>ii. The cost auditor shall be appointed by the directors with the prior approval of the Corporate Law Authority within sixty days of the close of financial year of the company.</p> <p>iii. The company shall apply to the Corporate Law Authority in the form set out in Appendix I for appointment of cost auditor not later than thirty days before the date on which cost</p>		<p>remuneration with a period of 30 days from the end of its each financial year: Provided that a person cannot be appointed or re-appointed as cost auditor without his or her written consent.</p> <p>(2) The person appointed as cost auditor of a Company under sub-rule (1) shall intimate the matter to the Government within a period of 15 days.</p> <p><b>Section 6.</b>-(1) A person cannot be appointed as a cost auditor unless he is a cost and management accountant as defined in the said Ordinance: Provided that a cost and management accountant cannot be appointed as a cost auditor unless he has a certificate of practice</p>		<p>to fall under violation of Rule 3(ii) as they have to be appointed within the last 60 days of the close of the financial year</p>

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		<p>auditor is to be appointed.</p> <p>iv. None of the following persons shall be appointed as cost auditor of a company, namely :-</p> <p>a. a person who has been appointed as auditor of the company for the respective period under section 252 of the Companies Ordinance, 1984</p> <p>b. a person who is, or at any time during the preceding three years was, a director, officer or employee of the company ;</p> <p>c. a person who is a partner of, or in the employment of, a director,</p>		<p>issued by the Institute of Cost and Management Accountants of Bangladesh established under the said Ordinance:</p> <p>Provided further that a firm whereof all the partners practicing in Bangladesh are qualified for appointment as aforesaid may be appointed by its firm name to be cost auditor of a company in which case any of the partners may act in the name of the firm.</p> <p>(2) None of the following persons shall be qualified for appointment as cost auditor of a company, namely-</p> <p>(a) an employee of company under audit;</p>		

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		<p>officer or employee of the company ;  d. a spouse of a director of the company ;  e. a person who is indebted to the company ; and  f. a body corporate.  <b>Explanation.-</b> In this sub-rule reference to an "officer" or "employee" shall be construed as not including reference to a cost auditor.  v. The remuneration of the cost auditor shall be fixed by the directors.</p>		<p>(b) a person who is a partner or served under an employee of the company under audit;  (c) a person who is indebted to the company for an amount exceeding one thousand taka, or who has given any guarantee or provided any security in connection with indebtedness of any third person to the company for an amount exceeding one thousand taka;  (d) a person who is a director of member of a private company, or partner of a firm, which is the managing agent of the company;  (e) a person who is a director, or the holder of shares exceeding five percent in nominal value of the subscribed capital, of anybody</p>		

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				<p>corporate which is the managing agent of the company;            Provided that where any shares held by a person as nominee or trustee for any third person and in which the holder has no beneficial interest. Such shares shall be excluded in computing the extent of the subscribed capital for the purpose of this clause.            (f) Appointed as auditor of the company according to section 210.</p> <p>Explanation:- For carrying out the purpose of this sub-rule the word “employee” shall not include as a cost auditor;            (3) A person shall not be</p>		

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				<p>qualified for appointment as a cost auditor of a company, if-</p> <p>(a) he, according to sub-rule (2), is disqualified for appointment as cost auditor of any other body corporate which is subsidiary of that company or holding company or holding company or a subsidiary of that company's ;</p> <p>(b) he would be disqualified for such appointment, had the said body corporate been-a company.</p> <p>(4) If a cost auditor becomes subject, after his appointment to any of the disqualifications specified in sub-rules(20 and (3), he shall be deemed to have vacated his office as such.</p>		

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4	<b>Cost Auditors Report</b>	<p>i. Every company shall, in addition to the records and statements specified in the order of the Corporate Law Authority issued under clause (e) of subsection (1) of section 230 of the Companies Ordinance, 1984, prepare -</p> <p>a. a statement of production capacity of the plant, in terms of machine hours and production units, the actual utilization of the capacity and the reasons of difference between the two; and</p> <p>b. a statement of</p>	<p>(1) Every cost auditor, who conducts an audit of the cost records of the company, shall submit the report along with auditor's observations and suggestions, and Annexure to the Central Government in the prescribed form and at the same time forward a copy of such report to the company.</p> <p>(2) The cost audit report submitted on or after 1st day of April, 2012, irrespective of the financial year of the company to which it relates, shall be in the form prescribed under these rules.</p> <p>(3) Every company as specified in sub-rule (1)</p>	<p><b>Section 7 Supplying cost accounting records, etc</b> .-The company ordered to have its accounts audited under section 220 shall make available cost accounting records maintained under section 181 (1) (d) and such other cost statements books and papers as May be prescribed by the concerned cost audit order that would be required for conducting the cost audit, and shall render necessary assistance to the cost auditor so as to enable him to conduct and complete the cost audit smoothly.</p> <p><b>Section 8. Submission of report.</b>-(1) Every cost auditor shall prepare</p>		

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		<p>stock-in-trade of the company as at the end of financial year in terms of quantity and cost thereof distinguishing between-</p> <p>I. stock of raw material and components;</p> <p>II. stock of work in process;</p> <p>III. stock of finished products; and</p> <p>IV. other stocks.</p> <p>ii. The statement specified in clauses (a) and (b) of sub-rule (1) shall be signed by the chief executive and chief accountant of the company.</p> <p>iii. The cost auditor shall make out a report within sixty days of his appointment to the directors in the form</p>	<p>of rule 3 shall, keep and maintain cost details, statements, schedules, etc. for each unit and each product or activity comprised in each product group, duly authenticated by at least two Directors of the company and the cost auditor.</p> <p>(4) The cost details, statements, schedules, etc. of every company, as specified in sub-rule (3), relating to a period of not less than eight financial years immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years shall be kept in good order:</p> <p>(5) Every cost auditor,</p>	<p>cost audit report (in duplicate) of the company under audit and in accordance with the procedures as laid down the end of the financial year, a report on the performance of its functions for that very year.</p> <p>(2) The cost auditor shall submit the report prepared by him to the board of directors of the company and a copy of the same shall be sent to the Government.</p> <p>(3) Cost auditor shall give clarification, if any, required by Government, on the cost audit report submitted by him within the time, the Government thinks fit.</p> <p><b>Section 9. Presentation of cost audit report.-(1)</b> The chief executive of</p>		

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		<p>set out in Appendix II along with a statement of capacity utilization and stock-in-trade as specified in clauses (a) and (b) of sub-rule (1) in the form set out in Appendix III and simultaneously shall submit two copies thereof to the Corporate Law Authority and the registrar concerned.</p> <p>iv. The company shall, within thirty days from the date of receipt of copy of the report, furnish the Corporate Law Authority with full information and explanation on every reservation or qualification contained in such</p>	<p>who submits a report under sub-rule (1), shall also furnish performance appraisal report, duly authenticated by the cost auditor, to the Board/Audit Committee of the company in the prescribed form.</p> <p>(6) Every cost auditor, who submits a report under sub-rule (1), shall also give clarifications, if any, required by the Central Government on the cost audit report submitted by him, within thirty days of the receipt of the communication addressed to him calling for such clarifications.</p>	<p>the company shall present the cost audit report to the board of directors within 30 days from the date of submission of the same by the cost auditor.</p> <p>(2) The cost audit report shall not ordinarily be open for inspection by the members or shall not be submitted to the annual general meeting of the company. Provided that if the Government considers it necessary for the interest of the general members may issue written order recording the reasons for the same to present the whole or part of the report in the next annual general meeting of the company; and in such case the subject</p>		

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		report.		shall be presented in the annual general meeting of the company; and in such case the subject shall be presented in the annual general meeting as directed by the Government.		
5	<b>Penalty</b>	Whoever fails or refuses to comply with, or contravenes any provision of these rules, or knowingly and willfully authorizes or permits such failure, refusal or contravention shall, in addition to any other liability under the Companies Ordinance, 1984, be also punishable with fine not exceeding two thousand rupees and, in case of	(1) If default is made by the cost auditor in complying with the provisions of rule 4 or rule 5, he/she shall be punishable with fine, which may extend to five thousand rupees. (2) If a company contravenes any provisions of these rules, the company and every officer thereof who is in default, including the persons referred to in sub-section (6) of section 209 of the Act, shall be punishable as provided	If any cost auditor or any officer of a concerned company contravenes the provisions of these rules, he/she or they, as the case may be, shall be punished with fine which may extend to one thousand taka.		

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		continuing failure, refusal or contravention, with a further fine not exceeding one hundred rupees for every day after the first during which such contravention continues.	under sub-section (2) of section 642 read with sub-sections (5) and (7) of section 209 and sub-section (11) of section 233B of Companies Act, 1956 (1 of 1956).			

## Annexure A

<b>LIST OF INDUSTRIES COVERED UNDER SECTION 209 (1) (d) OF THE COMPANIES ACT, 1956 India</b>			
<b>S.no.</b>	<b>Name of the Industry</b>	<b>S.no.</b>	<b>Name of the Industry</b>
1	Cement	24	Steel Tubes and Pipes
2	Cycles	25	Engineering
3	Tyres & Tubes	26	Electric Cables and Conductors
4	Air-Conditioners	27	Bearings
5	Refrigerators	28	Milk Food
6	Batteries other than Dry Cell Batteries	29	Chemicals
7	Electric Lamps	30	Formulations
8	Electric Fans	31	Steel Plant
9	Electric Motors	32	Insecticides
10	Motor Vehicles	33	Fertilizers
11	Aluminum	34	Soaps & Detergents
12	Vanaspati	35	Cosmetics & Toiletries
13	Bulk Drugs	36	Footwear
14	Sugar	37	Shaving Systems
15	Industrial Alcohol	38	Industrial Gases
16	Jute Goods	39	Mining and Metallurgy
17	Paper	40	Electronic Products
18	Rayon	41	Electricity
19	Dyes	42	Plantation Product
20	Polyester	43	Petroleum Industry
21	Nylon		
22	Textiles		
23	Dry Cell Batteries		

(a) Bulk Drugs, Formulation, Fertilizers, Sugar, Industrial alcohol, Electricity, Petroleum, Telecommunication Companies, meeting following criteria: (It covers these 8 specified Industries on which specific Cost Accounting Record Rules applies):

Aggregate value of Turnover > Rs. 20 crores in immediate preceding financial year, or Aggregate value of Net Worth > Rs. 5 crores as on last date of immediate preceding financial year, or Equity/Debt securities are listed or in process of listing in India or outside India

(b) Cement, Steel, Paper, Glass, Aluminum, Paints & Varnishes, Tyres & tubes, Insecticides Companies meeting following criteria: (It covers Industries on which general Cost Accounting Records Rules, 2011 applies):

Aggregate value of Turnover > Rs.100 crores in immediate preceding financial year, or Equity/Debt securities are listed or in process of listing in India or outside India

(c) Jute, Cotton, Silk, Woolen, or blend fibers/textiles, Edible oil seeds & oils (Incl vanaspati), Packing food Products, Organic and inorganic chemicals, Coal and lignite, Mining and Metallurgy of ferrous & non- ferrous Metal, Tractor and other motor Vehicles (including automotive components), Plantation Products, Engineering Machinery (Including electrical and electronic products)

Companies meeting following criteria: (It covers Industries on which general Cost Accounting Records Rules, 2011 applies):

Aggregate value of Turnover > Rs.100 crores in immediate preceding financial year, or Equity/Debt securities are listed or in process of listing in India or outside India.

## Annexure B

S.No.	LIST OF INDUSTRIES COVERED UNDER SECTION 258 OF THE COMPANIES ORDINANCE, 1984 PAKISTAN
1	Fertilizer
2	Thermal energy
3	Petroleum refining
4	Natural Gas
5	Polyester Fiber
6	Production, processing and manufacturing of pharmaceuticals products
7	Cement
8	Sugar
9	Vegetable Ghee/Edible Oil



## Annexure C

On 3<sup>rd</sup> December 2009 the government of Bangladesh issued a gazette notification introducing cost audit in 64 industries 42 of which are in textile, 12 in pharmaceuticals and the remaining 10 in state owned fertilizer sector industries.