The need for cost audit in enhancing reliance in the disclosed operational performance of organisations: The case of Nigeria

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In the present global business environment, cost reduction application has led to enhancing organisational value for many notable firms. However, in Nigeria, the situation is pathetic as companies incur high operational costs, in view of this reason, unit selling prices for most manufacturing outfit, including those of the market leader firms, are considered exorbitant. This work, therefore, focuses on the instrument that can be applied to curb the excessive cost and to enhance organisation value. The research makes use of both primary and secondary sources. In ensuring high validity of the primary data, questionnaire and interview methods were employed. The interviews and questionnaires were directed to some reputable manufacturing organisations in Nigeria, audit firms, retailers and selected investors in the public. The major finding revealed that, cost control system adopted is found not reliable and the conventional external audit assignment is not sufficient to rely on the disclosed operational performance of organisations in Nigeria. Based on this major finding, it is suggested that, there is a need for the government to introduce cost audit task in the public limited liability organisations and those of the government established commercialised and privatised companies in order to improve performance.

Key words: Cost audit, performance audit, propriety audit, operational performance.

INTRODUCTION

Government policies differ from one country to another. These policies have major effects on the performance of organisations that operate in a given particular country. Reliable and stable policies assist in the behavioural aspect of organisations. Ordinarily, cost structure should reflect correct operational performance of notable organisations. The other important considerations are that, achieving an improved performance in an organisation and company engaging high managerial and technical competence staff are catalyst of achieving competitive advantage. The global competitive environment has equally called for high productivity achievement.

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In a weak economy, cost audit programmes need to be introduced in order to assist in improving behavioural aspect of cost awareness.

**Review of literature**

The audited financial reports are globally regarded to portray reliable financial details of any organisation. The chartered institute of management accountants, London defines audit as systematic examination of the activities and status of an entity, based primarily on investigation and analysis of its systems, controls and records. The audited documents are therefore deemed to reflect operational performance of an organisation. However, there have been conflicting opinions over the acceptability of such vital documents. This is because with the drastic fall in share prices of many organisations, the report of some banks’ failure, the closure of some manufacturing operations in Nigeria, and the collapse of the American energy giant Enron, investors have lost confidence in financial auditing carried out by the reputable auditing firms in different countries.

Considering the financial crime, which auditors fail to discover during the audit assignment, it is possible to assume auditors are to be held liable for the inability to discover fraud, however, since auditors based their judgment on the information presented before them by the management and on scope of audit assignments, it follows that auditors cannot be held liable for the activities not covered by the audit task. The auditors are not responsible for the information in the financial statement. This is because management prepares the statements. Therefore, management is responsible for the information disclosed in the financial statements. As part of the audit task, the auditors is primarily responsible to perform and obtain reasonable assurance in connection with whether the financial statements are free from material misstatement, and that an audit provides reasonable assurance but not absolute, assurance of detecting material misstatement of the financial statements (Whittington and Pany, 2004).

The auditor is not to audit beyond the information contained in the financial statements. He should operate within the scope of the tasks assigned to him. In line with this presentation, Messier et al. (2006) are of the view that the auditor has no responsibility beyond the financial information contained in the report, and he or she has no obligation to perform any audit procedures to corroborate the other information. He however pointed further that, the auditor is required to read the other information and consider whether such information is consistent with the information contained in the financial statements.

One of the means by which a firm can be improving its operational performance from time to time is to establish a reliable cost management system. Thus, a firm that is inefficient in its resources utilisation will be producing at an unfavourable cost. Efficient firm therefore should establish an adequate control in its operational systems. One instrument, by which a firm can determine its level of efficiency of resources utilisation in fraudulent and weak legal systems, is to regularly carry out cost audit. This type of audit work has remained popular in India for a long time, and has proved beneficial to the economy in terms of relying on cost data presented by the manufacturing firms. It also paves the way for achieving both operational efficiency and keen competition.

The management accounting official terminology (2005) defines cost audit as “The verification of cost records and accounts and a check on the adherence to prescribed cost accounting procedures and the continuing relevance.” The institute of cost and works accountants of India (ICWAI) identifies cost audit to be an audit of efficiency of minute details of expenditure while the work is in progress and not a post-mortem examination.

From the definition, the attributes of a cost audit where reliable cost accounting procedures are already designed for the firm are given below:

1. Verifying that cost records are in line with the prescribed cost accounting procedures for the firm
2. Detecting of errors and prevention of frauds.
3. Reporting on finding on the outcome of the cost audit carried out and to give suggestions where necessary.
4. Examining the relevance of the costing procedures designed for the organisation in order to determine whether there is a need to further improve such procedures in line with the organisational changes and development that have taken place.
5. Assists in cost-plus contracts.

The form of the report as specified in the cost audit (Report) rules in India, as amended in 2001, States that:

1. Every cost auditor who conducts an audit of the cost accounting records of the company shall submit a report in triplicate to the Central Government.
2. Every cost auditor, who submits a report, shall also give clarifications, if any, required by the central government on the cost audit report submitted by him, within thirty days of receipt of the communication addressed to him calling for such clarifications.

The requirement of submission of cost audit report to federal government reduces manipulation of cost items by the management. For a cost audit task to be effectively carried out, a firm should engage the services of a cost consultant in designing its cost accounting procedures or give the responsibility to the firm’s cost accountant to execute the same. Sikka (2003) points out the objectives of cost audit to include the following:

1. Verify that cost accounting records are accurate.
2. Certify that costing principles have been fully adhered
3. Disclose the deficiencies or inefficiencies in the use of materials, labour, and machines, with a view to assist the management.
4. Check whether each item of expenditure involved into the relevant components of goods manufactured has been properly incurred.

**Cost audit as a continuous process**

Unlike financial audit that is concerned with the audit of past operations and covered a specified period, cost audit in its own case is carried out to audit the current operations and to compare the results with the past cost audit results. The cost audit task is executed on a continuous basis. The continuous audit of current operations carried out by cost auditors assists the firm to control cost and embark on cost reduction where possible.

**Forms of cost audit**

The two forms of cost audit are;

1. Performance or efficiency audit
2. Propriety audit

**Performance audit:** This form of cost audit is also known as efficiency audit: Its main objective focuses on whether the plan has been efficiently executed. It goes further to find out the extent to which the actual performance conforms to plan, which either results to favourable variance or unfavourable variance. The important consideration of efficiency audit is that it assists resources to be directed to the right channel thereby ensuring return on capital employed (ROI), is optimised. The assignment of efficiency audit commences from trying to study the plan. During the course of an investigation, the efficiency audit tries to identify whether labour remuneration including the incentive scheme designed for the firm is justified with the productivity put up by workers. It also tries to check the efficiency of material utilisation in the producing unit. Because of these foregoing tasks, efficiency audit is equally termed as profitability audit.

**Propriety audit:** This aspect of audit pertains to investigation of certain plans and actions taking by the management regarding the finances and expenditure of an organisation in order to be sure that such plans are not faulty and the actions taken are in the interest of the organisation for achieving optimum returns. The bone of contention in property audit is that expenditure incurred by the management in line with the approved plan is not a condition to assume that right decision has been executed unless the plan itself is considered appropriate. Because of the complex nature of property audit in determining whether correct plan was approved and right action was also taken, it is important that cost auditor finds out the extent to which:

1. Each approved expenditure would bring an optimum benefit to the firm
2. The approved plan is in line with the organisational goal
3. An alternative is considered more superior than the approved plan.
4. The expenditure approved and incurred is considered to be excessive.

**Major diversities between financial audit and cost audit**

In Nigeria, companies act is concerned with statutory audit w. This is different from the audit of cost accounts by internal or external persons appointed by the management. The major diversities between financial audit and cost audit are summarised below:

1. Audit of financial accounts is carried out on the past records to ensure expenditure incurred and sales generated were properly recorded. For this reason, financial audit is considered as a post-mortem check. On the other hand, cost audit is conducted on current operations, and compile the past audit results.
2. Financial audit is conducted on a specified past period agreed upon whereas no time limit for conducting cost audit assignments since its operations are continuous.
3. Financial audit is concerned with correct recording of expenditure and income to ensure they were not under or over recorded. However, cost audit emphasises on efficiency of executing plan and ascertain whether the plan approved by the management are in the interest of the organisation and go further to find out whether optimum returns have been achieved from the plans executed. It also finds out whether alternative plan would have been better off.
4. Financial audit is concerned with verification of financial records while cost audit tries to verify cost accounting records.
5. The assignment of cost audit extends to determining what should be the correct production and total cost whereas financial audit does not extends to such vital area.

**Designing a cost audit programme**

A cost auditor needs to design a cost audit programme for the organisation that is to be audited if he intends to
carry out a reliable and comprehensive cost audit assignment. A cost audit programme designed for a particular organisation may need to be updated or adjusted if it will be used to audit another organisation. Moreover, the complexity of an audit programme depends on the nature of the organisation to be audited, size, method of operations, types and numbers of products turned out, the effectiveness of internal control designed and used. A cost auditor must ensure that the scope of cost audit programme designed covers efficiency and propriety audit. It is significant to note that cost audit programme designed should be flexible to take care of likely changes or new operational tasks that management introduces from time to time.

A good cost audit programme should:

1. Cover relevant costing areas.
2. Provide a scientific procedure of recording the task performed.
3. Be able to identify the likely operational inefficiency that exists.
4. Be cost efficient and be able to reduce cost audit time.
5. Provide a good methodological approach in carrying out a cost audit task.
6. Be drawn in such a manner that will be possible to determine the significance of each cost item and will be able to compare the actual expenditure with the budgeted figures and be able to identify variances that exist.
7. Be able to avoid or minimise the possibility of omitting the significant cost audit test being carried out.

Cost audit programme designed should incorporate fraud prevention at each of the hierarchical structures otherwise, the goal of achieving a desirable unit cost that high level of performance will be difficult to achieve. Albrecht et al. (2008) are of the view that taking steps to create and maintain a culture of honesty and high ethics are part of the fundamental activities of fraud prevention.

Important areas of focus in cost audit programme

Even though requirements of a cost audit assignment differ from one organisation to another, it is mandatory that a cost auditor should identify and examine the following areas of focus in his cost audit programme:

1. The cost accounting system designed for organisation, and its degree of suitability or adequacy.
2. The frequency of cost audit required in each year of operation. This definitely depends on some factors such as size and methods of operations, nature and different types of product turned out.
3. Regularly reviewing of innovation introduced to the management plan and cost accounting system.
4. The nature and objective of cost audit to be carried out.
5. The cost control introduced to the entire operational system.
6. The effectiveness of the internal control system.
7. The scope of planning and maintenance units.
8. The organisation charts and manuals.

METHODOLOGY

Data utilised for this research were from both primary and secondary sources. In ensuring high validity of the primary data, questionnaire and interview methods were employed. The interviews conducted in the selected firms were directed to the managers in the relevant departments of some selected reputable manufacturing organisations in Nigeria, which include engineering unit, quality assurance unit, planning unit, purchasing unit, factory section and accounting unit. The questionnaires were mainly distributed to both the foremen in the factory and the factory workers. The secondary source makes use of available price lists of raw materials from major suppliers and as well find out the competitive remuneration packages payable in different types of manufacturing industries. The other categories were the selected investors in the public, retailers and the final consumers. Interviews were the only means of source of data collected for the three latter categories. The primary data collected were descriptively analysed. On the order hand, data gathered through secondary source were analysed through description, comparing with the competitors products quality, costs and pricing strategy, management capability, number of employee, technological innovation introduced, goals achieved.

Period of the research: The research covers a period of three years, commencing from year 2010 and ending year 2013

Findings

Generally speaking, in preparing financial statements, it is assumed that directors are deemed to be honest in their dealings that are associated with managing the business on behalf of the shareholders. But how far this assumption has remained reliable in Nigeria? Unfortunately, it is often observed that financial statements prepared by the company’s directors are misleading and are found not reliable simply because of errors of principles committed by the so called directors. The distortion of financial statement arises as a result of manipulation of records of transactions carried out by the firm. The degree of financial statement fraud differs in different organisation. The outcome of investigation conducted clearly indicates that the shareholders and the general public in Nigeria no longer trust the records of financial transactions published in form of financial reporting or annual reports.

Cost accounting focuses on operational efficiency of the firm, by trying to estimate reliable operational cost in advance of production and thereafter establishes cost control by comparing the actual operational results with the estimated figures (Iwarere 2004). In arriving at the estimated operational figures, cost accounting takes into consideration only normal cost and exclude completely
abnormal cost. Thus, the excessive costs incurred are written off to profit and loss account as against charging them to work in progress control account and finally transferred to finished goods control account when the goods are produced in the factory. Cost audit is concerned with the propriety and efficiency audit, unlike financial audit, cost audit tries to audit management plan and ensure no excessive cost is built into the plan figures.

The finding from the interview conducted with the companies' managers revealed that companies keep reliable transaction records. Hence, the view of the companies' managers is that company's financial statements are reliable. In spite of the foregoing findings some of the managers express that even though financial statements are reliable. It is still possible to identify errors committed because of large daily transactions carried out by the companies and the associated human problems identified. Managers in charge of internal control built into the system pave the way for a reliable financial statement, but insufficient statements generally lead to involvement of suspense accounts that may be corrected in the later period. Some of the managers operating outside accounting units agreed that they are not sufficiently knowledgeable about the information disclosed in the financial statements and that they were non-familiar with few of the terms used in the financial statements. However, purchasing managers denounced the possibility of overstatement of expenditure in the financial statements because all expenses to be incurred and any payment to be made must pass through expenditure control procedure. Hence, existence of fraud is always kept minimum if at all exist.

The internal auditors as well as other departments in charge of the preparation of financial statements are of the view that cost audit will only lead to duplication of audit assignment and that it will further lead to delay and augment cost spending. Thus, by assessing the views of the manager employed in the organisations, it is evident that fear of not losing their jobs could not enable them to be independent of expressing any possibility of fraud. They expressed that the establishment of a reliable internal control system in the organisations assists in achieving high operational performance.

However, the interview conducted to the factory workers produced contrary result as they were dissatisfied with the manner in which organisations are been managed. Most focus on job insecurity, low pay and high level of embezzlement. They expressed that financial statements are produced by the management, and the auditors are also appointed by the management hence it is not possible to rely on the information disclosed by the management in Nigeria.

The interview conducted to the retailers and consumers brought out different views, but majority views are in line with what the view of the factory workers and other junior staff of organisations visited. The retailers expresses that demand is not encouraging because of high level of poverty in the country. Approximately 25% of the retailers interviewed claimed that since they have some reasonable knowledgeable about price list of raw materials, it appears the price list of the manufactured goods are excessive. Majority of the retailers could not comment on the information disclosed in the financial statements but at the same time express dissatisfaction on the insufficient market demand.

The interview conducted to the consumers at the point of purchases which were mostly directed to the educated elites expresses that in spite of the auditor's reports presented on a yearly basis, there is still a high level of corruption, and that, since corruption is widely spread in the country and has become a way of life, introducing any other form of audit, whether involving cost audit or other form will not help in removing misstatement of financial statement. Approximately 60% of the consumer interviewed expressed that most directors operating in both public and private sectors are politicians, some of them cited example of the directors or their equivalent in both private and public sectors that are actively involved in politics and those that have been given high portfolio position after their retirement from office. The consumers equally expressed that even those that are yet to become directors will behave in similar corrupted manners if they get there because of high level of corruption in the country and high poverty rate. Their view is that leaders in the country use illegal wealth acquired to oppress the poor. Finally, approximately 90% of the consumers interviewed regretted that no economic theory work in Nigeria because of leadership problem.

The outcome of the interview conducted with the investors in the general public indicates that most organisations have not been paying cash dividend. They expressed that the high market price they purchased company shares before the outcome of share crash is a major disaster to them. Thus, by implication, stock exchange is to be held liable for the overprice market share. The investors also expressed that reports of the misappropriation of funds committed by the Nigerian directors are high and many directors of the public liability companies have big businesses on their own and this account for their extravagant spending. They at the same time expressed that in spite of the reports from the independent corrupt practices commission (ICPC), economic and financial crimes commission (EFCC), media houses that revealed their mismanagement and excessive private spending nothing serious happen. Since the investors were selected from the general public, their views focus more on the continuous bank failure. Thus, the respondents are of the view that introducing cost audit will not change the system because there is high level of corruption in both private and public establishment.
DISCUSSION

The financial statement prepared by the directors ordinarily should reflect correct operational performance in notable organisations whether private or public. There are records of internal control system introduced by all the large organisations, including those of public sectors organisations, but in spite of this control, there are records of mismanagement in different sectors of the economy.

There exist rapid financial institutional and manufacturing failures in the last two decades. Most of these misfortunes are attributed to the policy makers in both private and public sectors. For instance, most of the records of bank failure in Nigeria are always traced to the illegal transfer of huge funds out of the bank to personal use. In spite of mergers that takes place from time to time and increase in capitalisation of bank. Many middle managers put up their best in terms of efficiency, but the key policy makers which may either be the managing director or combination of key personnel have been identified to continually destroying the organisations. There seems to be complete lack of trust in the manner in which organisations are being managed. This same ugly situation is not limited to the financial institutions alone but equally widespread in the manufacturing and other sectors of the economy. The most disturbing aspect is the corrupt practices that are rampant in the public sector of the economy and the policy makers for the country are not helping situation as well.

The external auditors operate within the scope of information presented to them by the management. The internal auditors are insiders to the organisations. There is a weak legal system in the country because the court is not functioning independently. This pave the way for high economic mismanagement that accounts for high level of corruption in the country. The low current and constant power failure in the country is not the only factor responsible for the reduction in the capacity utilisation in the public limited companies owned by foreign firms, but the high level of corruption of: the indigenous directors, other management personnel, and other categories of staff form major reason for deciding to transfer some production activities to the neighbouring country.

Cost audit aims to address the issue of mismanagement of the company’s funds. It tries to achieve the costing objectives of high level of operational efficiency though establishing adequate cost control systems into the organisation. Unlike the external audit that is backward oriented in nature. Cost audit is concerned with engaging on daily audit of operational activities when the operations are in progress and not later. Moreover, in cost audit, there is no limit to areas of coverage as applicable to the external audit, which depends on the information presented to the auditors by the management. Thus, cost audit carried out both performance and propriety audit. To what extent can the goal of cost audit be achieved towards accelerating economic development in a highly corrupt environment, where there is a weak legal system in the country? Unless there is faithfulness on the part of the government and their agents, it is not likely that the unfaithfulness practices in both the public and private sectors can be checked. This is because in any country, authority flows from the government to the lower levels, which are the public and private sectors establishments. However, the unfaithfulness attitude has become a conventional practice in Nigeria.

There is high level of improper placement in different organisations and promotional policy adopted in many occasion is not based on merit. Unless a particular staff belongs to the core group or has a god father, even though the person is highly efficient and satisfies other promotional criteria, after getting to certain level, promotion becomes difficult. Also, the possibility of unjustifiable retrenchment exercise carried out from time to time without payment of compensation become eminent. Considering the high level of poverty and unemployment in the country majority of workers in different organisations including those working in the public sector organisations decide to padlock their mouth in order to safeguard their jobs. Company performs badly where personal interests of any of its top, middle and lower managers conflicts with the organisational objectives and that the extent to which this negative attitude affects the organisational performance strongly depends on the position held by the affected individual. Iwarere (2009) expressed that:

Management should consider skill, educational background, efficiency, innovative ability and experience for placement and promotional exercise.

He stretches further that it is worthwhile for leaders to adopt promotion policy that leads to the improvement of productivity. This is because promotion of empty brains affects development of an organisation in that when such personnel get to the top, they uplift other incompetent personnel and as well find means of impairing the efforts of the competent and efficient personnel because of the possible threat to the inefficient leaders. The foregoing should generally be the characteristics of private sector organisations, which was noticed in the past in Nigeria, but with the economic hardship, together with high level of corruption that spread across the country, the situation has completely changed. Many published financial reports are window dressed.

Thus, in view of the improper leadership style in the country and in different organisations within the country, there seems to be difficulty in introducing any other type of audit that will lead to the organisations performing to expectation without first revisiting, and as well, change
the leadership style mentioned in the foregoing. If government decides to eventually recommend cost audit for both public limited companies and government establishments, the government should ensure the following requirements are satisfied:

1. A qualified cost auditor should be appointed by a particular public liability company to carry out the cost audit task.
2. The audit assignment must cover efficiency and propriety audits.
3. Management must be mandated to release necessary documents to the cost audit task and will be made liable for withholding required information.
4. The cost auditor so appointed should operate independently from the management.
5. Every Cost Auditor who conducts an audit of the cost accounting records of the company as well as those relating government establishments is to be mandated to submit a report in duplicate to the federal government of Nigeria.
6. There should be federal government publications on cost audit reports, twice a year.
Each company, where cost audit task is carried out, should equally publish its cost audit report, separately in a well circulated newspaper in the country.
7. Cost auditor is to be made liable with adequate penalty for the reports generated by him.

Based on this major discussion in the above, it is suggested that, there is a need for the government to introduce cost audit task to cover both the public sector and the public limited companies in the country in order to improve performance.

Conflict of interest

The author has not declared any conflict of interest.

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