



Exposure Draft
SCA - Standard on Cost Auditing
Communication with Those Charged with Governance

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The following is the **Standard on Cost Auditing, “Communication with Those Charged with Governance”**. In this Standard, the standard portions have been set in ***bold italic*** type. This standard should be read in the context of the background material, which has been set in normal type.

1. Introduction

The purpose of this standard is to establish requirements for the cost auditor to communicate with those charged with governance in an audit of cost statements.

2. Objectives

The objectives of this standard are to enable the cost auditor:

- (a) To communicate clearly with those charged with governance the responsibilities of the cost auditor in relation to the audit of cost statements, and an overview of the planned scope and timing of the cost audit;***
- (b) To obtain from those charged with governance information relevant to the cost audit;***
- (c) To provide those charged with governance with timely observations arising from the cost audit that are significant and relevant to their responsibility to oversee the cost reporting framework; and***
- (d) To promote effective two-way communication between cost auditor and those charged with governance.***

3. Scope

3.1 This standard deals with the cost auditor’s responsibility to communicate with those charged with governance in an audit of cost statements. Although this standard applies irrespective of an entity’s governance structure or size, particular considerations apply where all of those charged with governance are involved in managing an entity. This Standard does not establish requirements regarding the cost auditor’s communication with an entity’s management or owners unless they are also charged with a governance role.

3.2 This standard applies in the context of an audit of cost statements, but may also be applicable, adapted as necessary in the circumstances, to audits of other cost



information when those charged with governance have a responsibility to oversee the preparation of the other cost information.

3.3 Recognizing the importance of effective two-way communication in an audit of cost statements, this standard provides an overarching framework for the cost auditor's communication with those charged with governance and identify some specific and additional matter to be communicated with them. Additional matters to be communicated, which complement the requirements of this SCA, are identified in other SCAs. Further matters, not required by this or other SCAs, may be required to be communicated by law or regulation, by agreement with the entity, or by additional requirements applicable to the engagement. Nothing in this Standard precludes the cost auditor from communicating any other matters to those charged with governance. (Refer 6.21 to 6.24)

3.4 The Role of Communication

(i) This standard focuses primarily on communications from the cost auditor to those charged with governance. Nevertheless, effective two-way communication is important in assisting:

- (a) The cost auditor and those charged with governance in understanding matters related to the audit, and in developing a constructive working relationship. This relationship is developed while maintaining the cost auditor's independence and objectivity;**
- (b) The cost auditor in obtaining from those charged with governance information relevant to audit. For example, those charged with governance may assist the cost auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific items of cost or events; and**
- (c) Those charged with governance in fulfilling their responsibility to oversee the cost reporting framework, thereby reducing the risks of material misstatement of the cost statements.**

(ii) Although the cost auditor is responsible for communicating matters required by this standard, management also has a responsibility to communicate matters of governance interest to those charged with governance. Communication by the cost auditor does not relieve management of this responsibility. Similarly, communication by management with those charged with governance of matters that the cost auditor is required to communicate does not relieve the cost auditor of the responsibility to also communicate them. Communication of these matters



by management may, however, affect the form or timing of the cost auditor's communication with those charged with governance.

(iii) Clear communication of specific matters required to be communicated by SCA is an integral part of every cost audit. SCAs do not, however, require the cost auditor to perform cost audit procedures specifically to identify any other matters to communicate with those charged with governance.

(iv) Law or regulation may restrict the cost auditor's communication of certain matters with those charged with governance. For example, laws or regulations may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the cost auditor's obligations of confidentiality and obligations to communicate may be complex. In such cases, the cost auditor may consider obtaining legal advice.

4. Definitions: The following terms are being used in this standard with meaning specified. Any term not defined in this Standard shall have the same meaning and expression as set out in the Glossary of Terms issued by the Council.

4.1 Governance: *Describes the role of person(s) or organization(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.*

5. Requirements

Those Charged with Governance

5.1 *The cost auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate. (Refer para 6.1 to 6.3)*

Communication with a Subgroup of Those Charged with Governance

5.2 *If the cost auditor communicates with a subgroup of those charged with governance, for example, an audit committee, or an individual, the cost auditor shall determine whether the auditor also needs to communicate with the governing body. (Refer para 6.4 to 6.6)*

When All of Those Charged with Governance are Involved in Managing the Entity

5.3 *In some cases, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matter required by this Standard are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be*



communicated again with those same person(s) in their governance role. These matters are noted in paragraph 5.6(c). The cost auditor shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the cost auditor would otherwise communicate in their governance capacity. (Ref: para 6.7)

Matters to Be Communicated

The Cost Auditor's Responsibilities in Relation to an audit of cost statements

5.4 The cost auditor shall communicate with those charged with governance the responsibilities of the cost auditor in relation to an audit of cost statement, including that:

- (a) The cost auditor is responsible for forming and expressing an opinion on the cost statements that have been prepared by management with the oversight of those charged with governance; and**
- (b) The audit of the cost statements does not relieve management or those charged with governance of their responsibilities. (Refer para 6.8 - 6.9)**

Planned Scope and Timing of the Cost Audit

5.5 The cost auditor shall communicate with those charged with governance an overview of the planned scope and timing of the cost audit. (Refer para 6.10 to 6.14):

Significant Findings from the Cost Audit

5.6 The cost auditor shall communicate with those charged with governance:

- (a) The cost auditor's views about significant qualitative aspects of the entity's cost accounting practices including cost accounting policies, cost accounting estimates and cost statement and related disclosures. When applicable, the cost auditor shall explain to those charged with governance why the cost auditor considers a significant cost accounting practice, that is acceptable under the applicable cost reporting framework, not to be most appropriate to the particular circumstances of the entity; (Refer para 6.15,6.16, Appendix-1)**
- (b) Significant difficulties, if any, encountered during the cost audit; (Refer para 6.17)**
- (c) Unless all of those charged with governance are involved in managing the entity:
 - (i) Significant matters, if any, arising from the cost audit that were discussed, or subject to correspondence with management; and (Refer para 6.18)****



- (ii) Written representations, the cost auditor is requesting; and**
- (d) Other matters, if any, arising from the cost audit that, in the cost auditor's professional judgment, are significant to the oversight of the cost reporting framework. (Refer para 6.19)**

Cost Auditor Independence

5.7 The cost auditor shall communicate with those charged with governance:(Refer para 6.20 to 6.25)

- (a) A statement that the audit team and others in the firm as appropriate, have complied with relevant ethical requirements regarding independence; and**
 - (i) All relationships and other matters between the firm and the entity that, in the cost auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by audit of cost statement and non-audit services provided by the firm to the entity including its units, branches or divisions ; and**
 - (ii) The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.**

The Communication Process

Establishing the Communication Process (Refer para 6.26 to 6.34)

5.8 The cost auditor shall communicate with those charged with governance the form, timing and expected general content of communications.

Forms of Communication (Refer para 6.35 to 6.37)

5.9 The cost auditor shall communicate in writing with those charged with governance regarding significant findings from the cost audit if, in the cost auditor's professional judgment, oral communication would not be adequate. Written communications need not include all matters that arose during the course of the audit.

5.10 The cost auditor shall communicate in writing with those charged with governance regarding auditor independence when required by paragraph 5.7.

Timing of Communications

5.11 The cost auditor shall communicate with those charged with governance on a timely basis. (Refer para 6.38 to 6.39)

Adequacy of the Communication Process



5.12 *The cost auditor shall evaluate whether the two-way communication between the cost auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the cost auditor shall evaluate the effect, if any, on the cost auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and shall take appropriate action. (Refer para 6.40 to 6.42).*

Documentation

5.13 *Where matters required by this Standard to be communicated are communicated orally, the cost auditor shall include them in the audit documentation, and when and to whom they were communicated. Where matters have been communicated in writing, the cost auditor shall retain a copy of the communication as part of the audit documentation. (Refer Para 6.43)*

6. Application Guidance

Those Charged with Governance (Refer para 5.1)

6.1 Governance structures vary by jurisdiction, legal backgrounds, size and ownership characteristics. For example:

- (a) In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure, for example, company directors. In others, for example, some government entities, a body that is not part of the entity is charged with governance.
- (b) In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.
- (c) In some cases, those charged with governance are responsible for approving the entity's cost statements (in other cases management has this responsibility).

6.2 In most entities, governance is the collective responsibility of a governing body, such as a board of directors, a committee of board or management, or equivalent persons. In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners. When governance is a collective responsibility, a subgroup such as an audit committee or even an individual, may be charged with specific tasks to assist the governing body in meeting its responsibilities. Alternatively, a subgroup or individual may have specific, legally identified responsibilities that differ from those of the governing body.



6.3 Such diversity means that it is not possible for this standard to specify the person(s) with whom the cost auditor is to communicate particular matters. Also, in some cases, the appropriate person(s) with whom to communicate may not be clearly identifiable from the applicable legal framework or cost audit engagement, for example, entities where the governance structure is not formally defined, such as some family-owned entities and some government entities. In such cases, the cost auditor may need to discuss and agree with the relevant person(s) with whom to communicate. In deciding with whom to communicate, the cost auditor's understanding of an entity's governance structure is required. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated.

Communication with a Subgroup of Those Charged with Governance (Refer para 5.2)

6.4 When considering communicating with a subgroup of those charged with governance, the cost auditor may take into account such matters as:

- (a) The respective responsibilities of the subgroup and the governing body.
- (b) The nature of the matter to be communicated.
- (c) Relevant legal or regulatory requirements.
- (d) Whether the subgroup has the authority to take action in relation to the information communicated, and can provide further information and explanations the cost auditor may need.

6.5 When deciding whether there is also a need to communicate information, in full or in summary form, with the governing body, the cost auditor may be influenced by the cost auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The cost auditor may make explicit in agreeing the terms of engagement that, unless prohibited by law or regulation, the cost auditor retains the right to communicate directly with the governing body.

6.6 Audit committees (or similar subgroups with different names) exist in many governance structures. Although their specific authority and functions may differ, communication with the audit committee, where one exists, has become a key element in the cost auditor's communication with those charged with governance. Good governance principles suggest that:

- (a) The cost auditor will be invited to regularly attend meetings of the audit committee.
- (b) The chairperson of the audit committee and, when relevant, the other members of the audit committee, will liaise with the cost auditor periodically.
- (c) The audit committee will meet the cost auditor without management present at least annually.



When All of Those Charged with Governance Are Involved in Managing the Entity (Refer Para 5.3)

6.7 In some cases, all of those charged with governance are involved in managing the entity, and the application of communication requirements is modified to recognize this position. In such cases, communication with person(s) with management responsibilities may not adequately inform all of those with whom the cost auditor would otherwise communicate in their governance capacity. For example, in a company where all directors are involved in managing the entity, some of those directors (for example, one responsible for marketing) may be unaware of significant matters discussed with another director (for example, one responsible for the preparation of the cost statements)

Matters to Be Communicated

The Cost Auditor's Responsibilities in Relation to Audit of the Cost Statement (Refer para 5.4)

6.8 The cost auditor's responsibilities in relation to audit of the cost statements are often included in the engagement letter or other suitable form of written agreement that records the agreed terms of the engagement. Providing a copy of that engagement letter or other suitable form of written agreement to those charged with governance may be an appropriate way to communicate with them regarding such matters as:

- (a) The cost auditor's responsibility is for performing the audit in accordance with standards on cost auditing and expression of an opinion on the cost statements. The matters that are required to be communicated, therefore, include significant matters arising from the audit of the cost statements, cost records or other related documents that are relevant to those charged with governance in overseeing the cost reporting framework.
- (b) The fact that standards on cost auditing do not require the cost auditor to design procedures for the purpose of identifying supplementary matters to communicate with those charged with governance.
- (c) When applicable, the cost auditor's responsibility for communicating particular matters required by law or regulation, by agreement with the entity or by additional requirements applicable to the cost audit engagement, for example Cost Accounting Standards issued by the Institute.

6.9 Law or regulation, an agreement with the entity or additional requirements applicable to the engagement may provide for broader communication with those charged with governance. For example, an agreement with the entity may provide for particular



matters to be communicated when they arise from services provided by a firm other than the cost audit.

Planned Scope and Timing of the Cost Audit (Refer para 5.5)

6.10 Communication regarding the planned scope and timing of the cost audit may:

- (a) Assist those charged with governance to understand better the consequences of the cost auditor's work, to discuss issues of risk and the concept of materiality with the cost auditor, and to identify any areas in which they may request the cost auditor to undertake additional procedures;
- (b) Assist the cost auditor to understand better the entity and its environment.

6.11 Care is required when communicating with those charged with governance about the planned scope and timing of the cost audit so as not to compromise the effectiveness of the cost audit, particularly where some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed cost audit procedures may reduce the effectiveness of those procedures by making them too predictable.

6.12 Matters communicated may include:

- (a) How the cost auditor proposes to address the significant risks of material misstatement, whether due to fraud or error;
- (b) The cost auditor's approach to internal control relevant to the cost audit;
- (c) The application of the concept of materiality in the context of cost audit.

6.13 Other planning matters that it may be appropriate to discuss with those charged with governance include:

- (a) Where the entity has an internal audit function, how the cost auditor and internal auditor can work in a constructive and complementary manner, including any planned use of the work of the internal audit function, and the nature and extent of any planned use of internal auditors to provide direct assistance.
- (b) The views of those charged with governance of:
 - (i) The appropriate person(s) in the entity's governance structure with whom to communicate.
 - (ii) The allocation of responsibilities between those charged with governance and management.
 - (iii) The entity's objectives and strategies, and the related business risks that may result in material misstatements.



- (iv) Matters those charged with governance consider warrant particular attention during the cost audit, and any areas where they request additional procedures to be undertaken.
 - (v) Significant communications with regulators.
 - (vi) Other matters that those charged with governance consider may influence the audit of the cost statements.
- (c) The attitudes, awareness, and actions of those charged with governance concerning:
- (i) the entity's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control, and
 - (ii) the detection or possibility of fraud.
- (d) The actions of those charged with governance in response to developments in cost accounting standards, corporate governance practices, and other related matters.
- (e) The responses of those charged with governance to previous communications with the cost auditor.

6.14 While communication with those charged with governance may assist the cost auditor to plan the scope and timing of the cost audit, it does not change the cost auditor's sole responsibility to establish the overall audit strategy and the cost audit plan, including the nature, timing and extent of procedures necessary to obtain sufficient appropriate audit evidence.

Significant Findings from the Cost Audit (Refer para 5.6 (a))

6.15 The communication of findings from the cost audit may include requesting further information from those charged with governance in order to complete the audit evidence obtained. For example, the cost auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific treatment of items of cost or events.

Significant Qualitative Aspects of Cost Accounting Practices (Refer para 5.6 (a))

6.16 Cost reporting frameworks ordinarily allow for the entity to make cost estimates, and judgments about cost accounting policies and cost statement disclosures. Open and constructive communication about significant qualitative aspects of the entity's cost accounting policies and practices may include comment on the acceptability of significant cost accounting policies and practices. Appendix 1 identifies matters that may be included in this communication.

Significant Difficulties Encountered during the Cost Audit (Refer para 5.6 (b))



6.17 Significant difficulties encountered during the Cost audit may include such matters as:

- (a) Significant delays in providing required information by management.
- (b) An unnecessarily short time within which to complete the cost audit.
- (c) Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- (d) The unavailability of expected information.
- (e) Restrictions imposed on the cost auditor by management.
- (f) In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the cost auditor's opinion.

Significant Matters Discussed, or Subject to Correspondence with Those Charged With Governance (Refer para 5.6 (c))

6.18 Significant matters discussed, or subject to correspondence with those charged with governance may include such matters as:

- (a) Business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement.
- (b) Discussions or correspondence in connection with the initial or recurring appointment of the cost auditor regarding cost accounting policies, the application of standards on cost auditing, or for cost audit or other services.

Other Significant Matters Relevant to the Cost Reporting Framework (Refer para 5.6 (d))

6.19 Other significant matters arising from the cost audit that are directly relevant to those charged with governance in overseeing the cost reporting framework may include such matters as material misstatements of fact or material inconsistencies in information accompanying the audited cost statements that have been corrected.

Cost Auditor Independence (Refer para 5.7)

6.20 The cost auditor is required to comply with relevant ethical requirements, including those pertaining to independence, relating to cost audit engagements.

6.21 The relationships and other matters, and safeguards to be communicated, vary with the circumstances of the cost audit engagement, but generally address:

- (a) Threats to independence, which may be categorized as: self-interest threats, self-review threats, advocacy threats, familiarity threats, and intimidation threats; and
- (b) Safeguards created by the profession, legislation or regulation, safeguards within the entity, and safeguards within the firm's own systems and procedures.



The communication required may include an inadvertent violation of relevant ethical requirements as they relate to cost auditor independence, and any remedial action taken or proposed.

Supplementary Matters (Refer para 5.7)

6.22 The oversight of control by those charged with governance includes ensuring that the entity designs, implements and maintains appropriate internal control with regard to reliability of cost reporting framework, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

6.23 The cost auditor may become aware of supplementary matters that do not necessarily relate to the oversight of the cost reporting framework but which are, nevertheless, likely to be significant to the responsibilities of those charged with governance in overseeing the strategic direction of the entity or the entity's obligations related to accountability. Such matters may include, for example, significant issues regarding governance structures or processes, and significant decisions or actions by senior management that lack appropriate authorization..

6.24 In determining whether to communicate such matters with those charged with governance, the cost auditor may discuss matters with the appropriate level of management, unless it is inappropriate to do so in the circumstances.

6.25 If a supplementary matter is communicated, it may be appropriate for the cost auditor to make those charged with governance aware that:

- (a) Identification and communication of such matters is incidental to the purpose of the cost audit, which is to form an opinion on the cost statements;
- (b) No procedures were carried out with respect to the matter other than any that were necessary to form an opinion on the cost statements; and
- (c) No procedures were carried out to determine whether other such matters exist.

The Communication Process

Establishing the Communication Process (Refer para 5.8)

6.26 Clear communication of the cost auditor's responsibilities, the planned scope and timing of the cost audit, and the expected general content of communications helps establish the basis for effective two-way communication.



6.27 Matters that may also contribute to effective two-way communication include discussion of:

- (a) The purpose of communications. When the purpose is clear, the cost auditor, and those charged with governance are better placed to have a mutual understanding of relevant issues and the expected actions arising from the communication process.
- (b) The form in which communications will be made.
- (c) The person(s) in the audit team and amongst those charged with governance who will communicate regarding particular matters.
- (d) The cost auditor's expectation that communication will be two-way, and that those charged with governance will communicate with the cost auditor matters they consider relevant to the cost audit, for example, strategic decisions that may significantly affect the nature, timing and extent of cost audit procedures, the suspicion or the detection of fraud, and concerns with the integrity or competence of senior management.
- (e) The process for taking action and reporting back on matters communicated by the cost auditor.
- (f) The process for taking action and reporting back on matters communicated by those charged with governance.

6.28 The communication process will vary with the circumstances, including the size and governance structure of the entity, how the entity operate, and the cost auditor's view of the significance of matters to be communicated. Difficulty in establishing effective two-way communication may indicate that the communication between the cost auditor and those charged with governance is not adequate for the purpose of the cost audit.

Consideration Specific to Smaller Entities (Refer para 5.8)

6.29 In the case of audits of smaller entities, the cost auditor may communicate in a less structured manner with those charged with governance than in the case of larger entities.

Communication with Management (Refer para 5.8)

6.30 Many matters may be discussed with management in the ordinary course of cost audit, including matters required by this standard to be communicated with those charged with governance. Such discussions recognize management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for the preparation of the cost statements.

6.31 Before communicating matters with those charged with governance, the cost auditor may discuss them with management, unless that is inappropriate. For example, it may not be appropriate to discuss questions of management's competence or integrity with



management. In addition to recognizing management's executive responsibility, these initial discussions may clarify facts and issues, and give management an opportunity to provide further information and explanations. Similarly, when the entity has an internal audit function, the cost auditor may discuss matters with appropriate individuals within the function before communicating with those charged with governance.

Communication with Third Parties (Refer para 5.8)

6.32 Those charged with governance may wish to provide cost information to third parties, for example, job worker or sub-contractor or tax or certain regulatory authorities with copies of a written communication from the cost auditor. In some cases, disclosure to third parties may be illegal or otherwise inappropriate. When a written communication prepared for those charged with governance is provided to third parties, it may be important in the circumstances that the third parties be informed that the communication was not prepared with them in mind, for example, by stating in written communications with those charged with governance:

- (a) That the communication has been prepared for the sole use of those charged with governance, and should not be relied upon by third parties;
- (b) That no responsibility is assumed by the cost auditor to third parties ; and
- (c) Any restrictions on disclosure or distribution to third parties.

6.33 In some cases, the cost auditor may be required by law or regulation to, for example:

- (a) Notify a regulatory or enforcement body of certain matters communicated with those charged with governance. For example, in some cases, the cost auditor has a duty to report misstatements to authorities where management and those charged with governance fail to take corrective action;
- (b) Submit copies of certain reports prepared for those charged with governance to relevant regulatory or other government bodies, such as Income Tax Department or Excise Department or telecom regulatory authority.

6.34 Unless required by law or regulation to provide a third party with a copy of the cost auditor's written communications with those charged with governance, the cost auditor may need the prior consent of those charged with governance before doing so.

Forms of Communication (Refer para 5.9 – 5.10)

6.35 Effective communication may involve structured presentations and written reports as well as less structured communications, including discussions. The cost auditor may communicate matters other than those identified either orally or in writing. Written



communications may include an engagement letter that is provided to those charged with governance.

6.36 In addition to the significance of a particular matter, the form of communication (for example, whether to communicate orally or in writing, the extent of detail or summarization in the communication, and whether to communicate in a structured or unstructured manner) may be affected by such factors as:

- (a) Whether the matter has been satisfactorily resolved.
- (b) Whether management has previously communicated the matter.
- (c) The size, operating structure, control environment, and legal structure of the entity.
- (d) In the case of an audit of special purpose cost statements, whether the cost auditor also audits the entity's general purpose cost statements.
- (e) Legal requirements. In some cases, a written communication with those charged with governance is required in a prescribed form by law and regulation.
- (f) The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the cost auditor.
- (g) The numbers of meetings and dialogues the cost auditor has with those charged with governance.
- (h) Whether there have been significant changes in the members of Board of Directors or in management structure of entity.

6.37 When a significant matter is discussed with an individual member of those charged with governance, for example, the chairperson of an audit committee or chief executive officer, it may be appropriate for the cost auditor to summarize the matter in later communications so that all of those charged with governance have full and balanced information.

Timing of Communications (Refer para 5.11)

6.38 The appropriate timing for communications will vary with the circumstances of the engagement. Relevant circumstances include the significance and nature of the matter, and the action expected to be taken by those charged with governance. For example:

- (a) Communications regarding planning matters may often be made early in the cost audit engagement and, for an initial engagement, may be made as part of agreeing the terms of the engagement.
- (b) It may be appropriate to communicate a significant difficulties encountered during the cost audit as soon as practicable if those charged with governance are able to assist the cost auditor to overcome the difficulty, or if it is likely to lead to a modified opinion. Similarly, the cost auditor may communicate orally to those charged with governance as



soon as practicable significant deficiencies in internal control that the auditor has identified, prior to communicating these in writing.

(c) Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards, for example, when accepting an engagement to provide non-audit services, and at a concluding discussion. A concluding discussion may also be an appropriate time to communicate findings from the cost audit, including the cost auditor's views about the qualitative aspects of the entity's cost accounting policies.

(d) When auditing both general purpose and special purpose cost statements, it may be appropriate to coordinate the timing of communications.

6.39 Other factors that may be relevant to the timing of communications include:

(a) The size, operating structure, control environment, legal and regulatory structure of the entity being audited.

(b) Any legal obligation to communicate certain matters within a specified timeframe.

(c) The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the cost auditor.

(d) The time at which the cost auditor identifies certain matters, for example, the cost auditor may not identify a particular matter such as noncompliance with a law, in time for preventive action to be taken, but communication of the matter may enable remedial action to be taken.

Adequacy of the Communication Process (Refer para 5.12)

6.40 The cost auditor need not design specific procedures to support the evaluation of the two-way communication between the cost auditor and those charged with governance; rather, that evaluation may be based on observations resulting from cost audit procedures performed for other purposes. Such observations may include:

(a) The appropriateness and timeliness of actions taken by those charged with governance in response to matters raised by the cost auditor. Where significant matters raised in previous communications have not been dealt with effectively, it may be appropriate for the cost auditor to inquire as to why appropriate action has not been taken, and to consider raising the point again. This avoids the risk of giving an impression that the cost auditor is satisfied that the matter has been adequately addressed or is no longer significant.

(b) The apparent openness of those charged with governance in their communications with the cost auditor.

(c) The willingness and capacity of those charged with governance to meet with the cost auditor without management present.



- (d) The apparent ability of those charged with governance to fully comprehend matters raised by the cost auditor, for example, the extent to which those charged with governance probe issues, and question recommendations made to them.
- (e) Difficulty in establishing with those charged with governance a mutual understanding of the form, timing and expected general content of communications.
- (f) Where all or some of those charged with governance are involved in managing the entity, their apparent awareness of how matters discussed with the cost auditor affect their broader governance responsibilities, as well as their management responsibilities.
- (g) Whether the two-way communication between the cost auditor and those charged with governance meets applicable legal and regulatory requirements.

6.41 An effective two-way communication assists both the cost auditor and those charged with governance. Inadequate two-way communication may indicate an unsatisfactory control environment and influence the cost auditor's assessment of the risks of material misstatements. There is also a risk that the cost auditor may not have obtained sufficient appropriate audit evidence to form an opinion on the cost statements.

6.42 If the two-way communication between the cost auditor and those charged with governance is not adequate and the situation cannot be resolved, the cost auditor may take such actions as:

- (a) Modifying the cost auditor's opinion on the basis of a scope limitation.
- (b) Obtaining legal advice about the consequences of different courses of action.
- (c) Communicating with relevant regulatory or other government bodies, such as Central Excise Department or Telecom Regulatory Authority of India.
- (d) Withdrawing from the cost audit engagement, where withdrawal is possible under applicable law or regulation.

Documentation (Refer para 5.13)

6.43 Documentation of oral communication may include a copy of minutes prepared by the entity retained as part of the cost audit documentation where those minutes are an appropriate record of the communication.

7. Effective Date

This standard is effective for audits on or after.....

8. Statement of Modifications: Modifications to ISA 260, "Communication with Those Charged with Governance"



The ISAs have been developed with focus on Auditing of Financial Statements, while the focus of SCAs is on Auditing of Cost Statements. Hence, following changes are introduced across all the SCAs:

1. Change of 'terms' used in the ISAs that have corresponding meaning in cost audit vis-à-vis financial audit, such as Auditor with Cost Auditor, Audit with Cost Audit, Financial Statements with Cost Statements, Financial Reporting with Cost Reporting, Audit Procedures with Cost Audit Procedures, Auditor's Responsibility with Cost Auditor's Responsibility, etc.;
2. Corresponding modification in definitions of similar terms, examples used and in the Application Guidance;

* Deletions

Paragraph (A4, A23) has been deleted as the same is not relevant to the Audit of Cost Statements in Indian context.

Appendix 1

(Refer 5.6(a), 6.16)

Qualitative Aspects of Cost Accounting Practices

The communication required by 5.6(a), and discussed in 6.16, may include such matters as:

1.1 Cost Accounting Policies

(a) The appropriateness of the Cost accounting policies to the particular circumstances of the entity, having regard to the need to balance the cost of providing information with the likely benefit to users of the entity's cost statements. Where acceptable alternative cost accounting policies exist, the communication may include identification of the cost statement items that are affected by the choice of cost accounting policies as well as information on cost accounting policies used by similar entities.

(b) The initial selection of and changes in significant cost accounting policies. The communication may include:

- (i) the effect of treatment of items of cost and method of adoption of a change in cost accounting policy on the current and future cost of production or operation, cost of sales, and margin of the entity; and
- (ii) the timing of a change in cost accounting policies in relation to notification of cost accounting standards by the Institute.

(c) The effect of cost accounting policies in controversial or emerging areas (or those unique to an industry, particularly when there is a lack of authoritative guidance or consensus such as industry regulated by special law).

(d) The effect of the timing of items of cost in relation to the period in which they are recorded.



1.2 *Cost Accounting Estimates*

For items for which estimates are significant for example:

- (a) Management's identification of cost centres.
- (b) Management's process for treatment of items of cost.
- (c) Risks of material misstatement.
- (d) Indicators of possible management bias.
- (e) Disclosure of treatment of items of cost, uncertainty in the cost statements.

1.3 *Cost Statement Disclosures*

- (a) The issues involved, and related judgments made, in formulating particularly sensitive cost statement disclosures (for example, disclosures related to material consumption, scrap, items of cost, cost heads, capacity determination, and abnormal loss issues).
- (b) The overall neutrality, consistency and clarity of the disclosures in the cost statements.

1.4 *Related Matters*

- (a) The potential effect on the cost statements of significant risks, exposures and uncertainties, such as stock valuation that are disclosed in the cost statements.
- (b) The extent to which the cost statements are affected by unusual treatment of non-cost items as cost items or vice a versa treatment, during the period, and the extent to which such items are separately disclosed in the cost statements.
- (c) The factors affecting treatment of items of cost on the stock valuation. The communication may explain how factors affecting such valuation of stock were selected and how alternative selections would have affected the cost statements.
- (d) The selective correction of misstatements, for example, correcting misstatements with respect to cost of production or operation, the effect of increasing reported margins, but not those that have the effect of decreasing reported margins.