THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

(Statutory Body under an Act of Parliament)

Exposure Draft to Practical Guide to Standards on Cost Auditing

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A Manual for Audit of Cost Statements

Cost Auditing & Assurance Standards Board

Disclaimer

In exercise of the powers conferred under section 148(3) of the Companies Act 2013, the Institute of Cost Accountants of India, with the approval of the Central Government, has issued the following Standards on Cost Auditing:

- SCA-101 on *Planning an Audit of Cost Statements*,
- SCA-102 on *Audit Documentation*,
- SCA-103 on *Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards*, and
- SCA-104 on *Knowledge of Business, its Processes and the Business Environment*

In furtherance of its objectives, Council of the Institute has approved 15 more Standards on Cost Auditing viz. SCA-105 to SCA-119 that are still in process of approval by the Central Government. However, for better understanding of professional members, students and other stakeholders, relevant material has been drawn from these 15 Standards as well. These Standards, as they stand today, are available on the Institute's website. Any changes made in these Standards by the Central Government, to the extent used in this Practical Guide, shall stand replaced accordingly and be read & understood as per the approved version.

This Practical Guide has been designed to assist the practitioners/ members/ stakeholders for better understanding of Standards of Cost Auditing, but is not intended to be a substitute for the requirements under SCAs themselves. The members should utilize this guide in light of his/her professional judgement and facts and circumstances involved in each particular cost audit. The Cost Audit & Assurance Standards Board and the Council of the Institute disclaims any responsibility or liability that may occur, directly or indirectly, as consequence of the use and application of this Practical Guide.

The Institute of Cost Accountants of India is a founder member of the International Federation of Accountants (IFAC).

Standards on Cost Auditing [SCAs] issued by the Institute are, in-principle, based on the International Standards on Auditing [ISAs] issued by the International Auditing and Assurance Standards Board (IAASB) established under the authority of IFAC, with suitable modifications in framework and content wherever found necessary.

Accordingly, this Practical Guide is also largely based on the Guide to Using International Standards on Auditing in the Audit of Small-and Medium-Sized Entities issued by the IFAC,

1. Volume 1 – Core Concepts
2. Volume 2 – Practical Guidance

CONTENTS

List of the Cost Auditing Standards / Standards on Cost Auditing

The following are the Standards of Auditing issued by Institute of Cost Accountants of India till March -17 are classified in two categories are; (1) **Mandatory** (Approved by Ministry of Corporate Affairs) 2. **Recommendatory** (Approved by Council of Institute of Cost Accountants of India)

Mandatory

CAS -101	*Planning an Audit of Cost Statements*
CAS -102	*Audit Documentation*
CAS -103	*Overall Objectives of the Independent Cost Auditor andthe Conduct of an Audit in Accordance with Cost Auditing Standards*
CAS -104	*Knowledge of Business, its Processes and the Business Environment*

Recommendatory

SCA- 105	*Agreeing the Terms of Cost Audit Engagements*
SCA- 106	*Audit Sampling*
SCA- 107	*Audit Evidence*
SCA- 108	*Materiality in Planning and Performing a Cost Audit*
SCA- 109	*Cost Auditor's Responsibility relating to Fraud in an Audit of Cost Statements*
SCA- 110	*Written Representations*
SCA- 111	*Evaluation of Misstatements identified during the Cost Audit*
SCA- 112	*Analytical Procedures*
SCA- 113	*Using the work of Internal Auditor*
SCA- 114	*Using the work of Cost Auditor's Expert*
SCA- 115	*Communication with Those Charged with Governance*
SCA- 116	*Communicating Deficiencies in Internal Control*
SCA- 117	*Identifying and Assessing the Risks of Material Misstatements*
SCA- 118	*The Cost Auditor's Responses to Assessed Risks*
SCA- 119	*Related Parties*

CHAPTER –1 INTRODUCTION

PREAMBLE

Cost Accounting is process of identification, classification, measurement, and assignment of costs to various cost objects. Preparation & Presentation of cost records and cost statements is the responsibility of the Management. Therefore, Cost Accounting standards are guidelines for the companies [for the management] that specify the cost accounting treatment for various cost elements, minimum disclosure requirements and ensure the comparability, consistency, and completeness of cost records.

Cost Audit is an independent examination of cost statements, cost records and other related information of an entity, with a view to express an opinion thereon. Standards on Cost Auditing provide guidance to the cost auditor through each step of the audit process with regard to the audit procedures to be followed; responsibilities of the cost auditor; and cost reporting.

Standards are nothing what converting the commonly accepted practices, procedures and requirements into a document called "Standard". Practices, procedures and principles relating to cost accounting are covered in the Cost Accounting Standards; and practices, procedures and requirements relating to cost auditing are covered in the Standards on Cost Auditing.

Standards on Cost Auditing are best friends, best guide and best helpdesk for the cost auditor. If followed scrupulously, the standards would help the cost auditor to streamline audit, to do better planning, better documentation, and effective implementation. Thus, these will help in improving the overall quality of audit. The cost auditor should carefully go through the standards and make best use of them. Should read SCA 103 first [objectives of independent audit], then 104 [understanding the business], followed by 101 [planning] and 102 [documentation]. Take the client on board; send him a brief of the applicable Standards and discuss. Use the standards to the extent these are applicable to the nature and scope of audit. The Standards authorize the cost auditor to use the work of another auditor or expert – hence if satisfied, do not check every detail again which is already audited by another auditor or is certified by an expert. Therefore, if required & satisfied, the cost auditor can rely on the work done by another auditor/expert. The Standards are not to be remembered, but to be practiced by making these a part of the work culture and teaching these to the entire audit team.

BACKGROUND

Second Proviso to section 148(3) of the Companies Act, 2013 states that the auditor conducting cost audit shall comply with the cost auditing standards. As per the 'Explanation' below this proviso, the expression 'cost auditing standards' mean such standards as are issued by the Institute of Cost Accountants of India with the approval of the Central Government.

In accordance with the aforesaid provisions of Companies Act, 2013 and after approval by the Central Government, the Institute of Cost Accountants of India has issued four Standards on Cost Auditing SCA/CAS-101 to 104. Meanwhile, Council of the Institute has approved & issued fifteen more Standards on Cost Auditing viz. SCA-105 to SCA-119 that are still in process of approval by the Central Government. For better understanding of professional members, students and other stakeholders, relevant material has been drawn from all the nineteen Standards, including the 15 Standards awaiting Central Government approval.

The Standards on Cost Auditing are considered necessary to guide the members in audit of cost statements so that it is performed in an efficient and effective manner to ensure achievement of audit objectives with available resources and securing coordination with the auditee on audit work as mandated under section 148 of the Companies Act, 2013. The Guidance Note deal with the practical aspects of audit of cost statements in accordance with the requirements enshrined in SCAs-101-119

While formulating the Standards, the Cost Auditing & Assurance Standards Board [CAASB] of the Institute takes into consideration the applicable laws, usage and business environment prevailing in India. CAASB also takes into account the relevant provisions of Cost and Works Accountants Act, Rules and Regulations, Code of Professional Ethics, Cost Accounting Standards and other Statements issued by the Institute. The Standards issued by the CAASB are aligned, to the extent possible, with other recognised Standards issued in India and prevailing International Practices.

Note: As already said in the Preface to the Standards on Cost Auditing, if a particular Standard or any part thereof is inconsistent with a law, the provisions of the said law shall prevail.

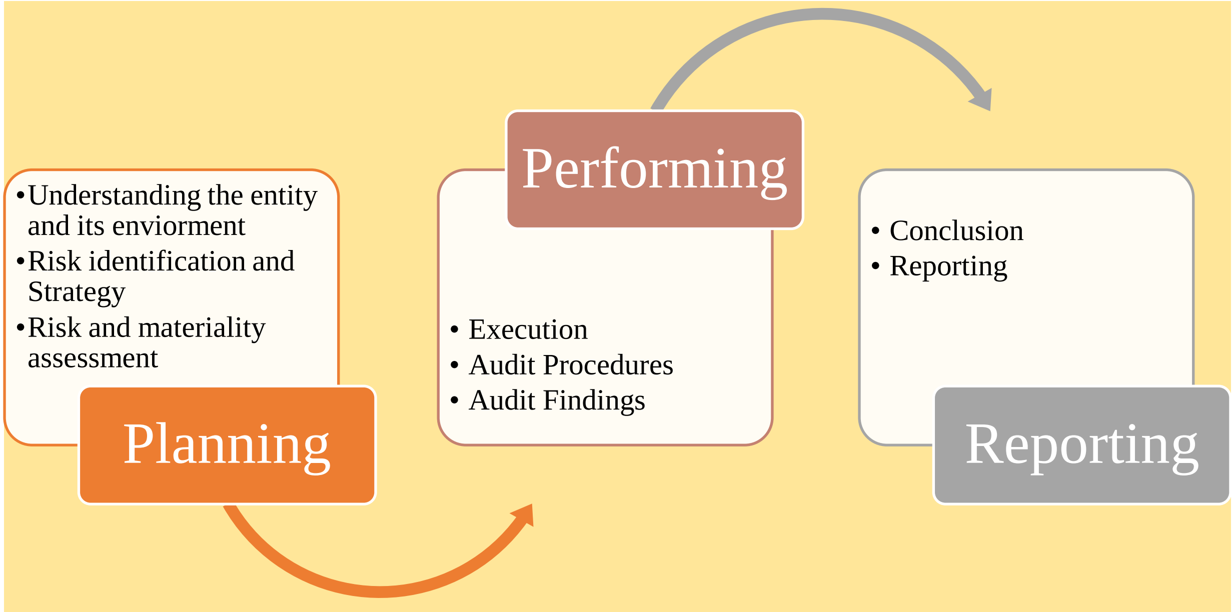
1.1 AUDIT STAGES

The stages of an audit of cost statements are

1) Planning
2) Performing and
3) Reporting

Figure below gives a pictorial view of these three stages.

Overview of the Cost Audit



Once the entity's acceptance or continuation decision has been made, the first stage is planning the audit. Broadly, the planning stage involves gaining an understanding of the client, identifying factors that may impact the risk of a material misstatement in the cost statements, performing a risk and materiality assessment, and developing an audit strategy. The risk of a material misstatement is the risk that the cost statements include a significant error or fraud. The execution stage (or performing stage) of the audit involves the performance of detailed testing of internal controls and substantive testing of cost accounting policies & procedures. The reporting stage involves evaluating the results of detailed testing in light of the cost auditor's understanding of the entity and forming an opinion on the fair presentation of the entity's cost statements as a whole.

1.1.1 Planning an Audit - First Stage

"It is well said that a well planned audit is almost half way done"

The planning stage involves determining the audit strategy as well as identifying the nature and the timing of the procedures to be performed. This is done to optimize efficiency and effectiveness when conducting an audit. Efficiency refers to the amount of time spent gathering audit evidence. Effectiveness refers to the minimization of audit risk. A well-planned audit will ensure that sufficient appropriate evidence is gathered to minimize risk of material misstatement at the cost statement level. The figure above provides a graphical depiction of the preliminary risk identification process used during the planning stage of each audit.

1.1.2 Performing an Audit – Second Stage

The performance, or execution, stage of the audit involves detailed testing of internal controls, material consumptions, cost accumulation, allocation, apportionment, and absorption. If an auditor plans to rely on their client's system of internal controls, they will conduct tests of controls. Cost auditor will conduct detailed substantive tests of audit procedures for the period and detailed substantive tests of consumptions and balances recorded at the period end. This detailed testing provides the evidence that the cost auditor requires to determine whether the cost statements have been fairly presented.

1.1.3 Concluding and Reporting on an Audit – Final Stage

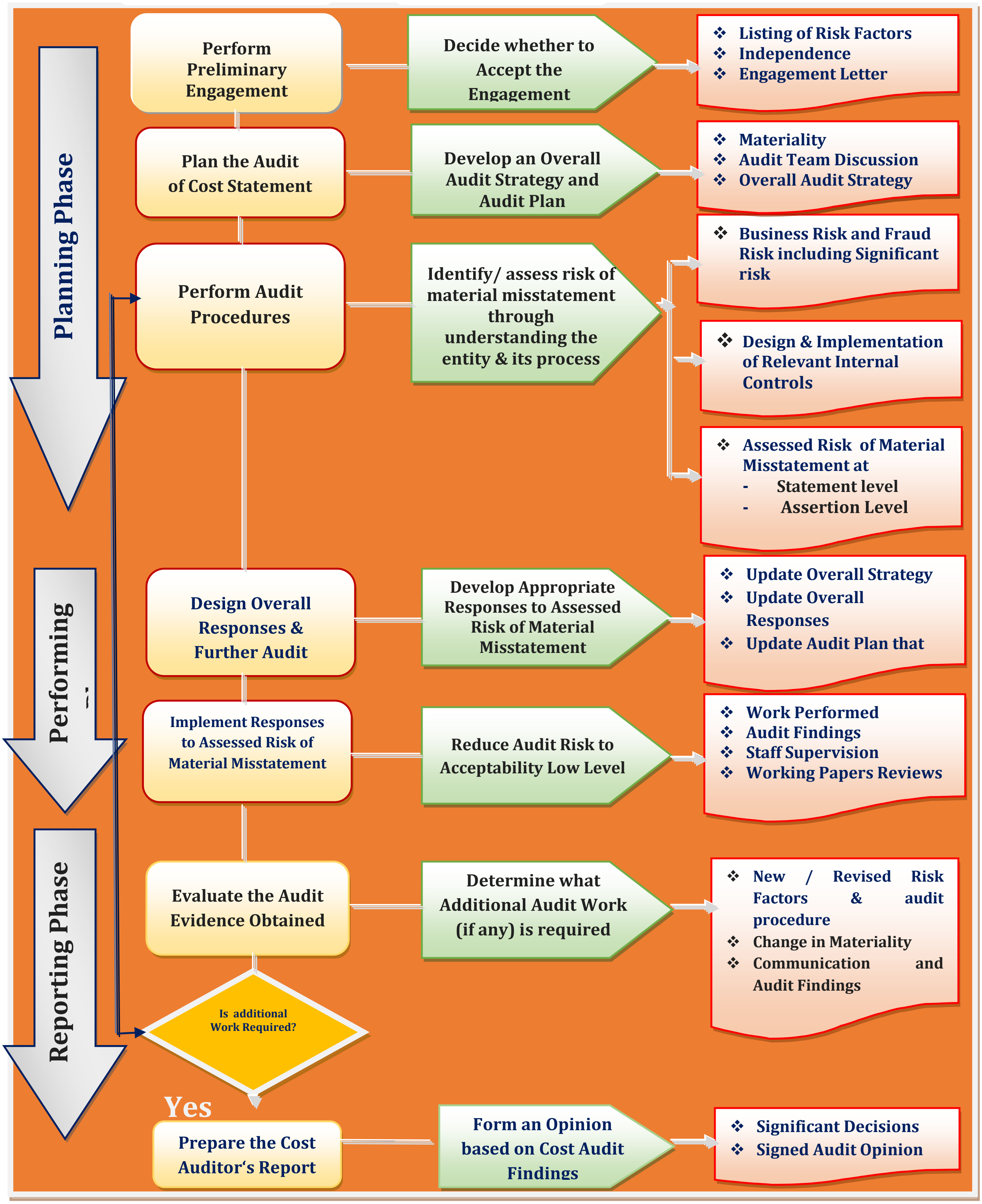
The final stage of the audit involves drawing conclusions based on the evidence gathered and arriving at an opinion regarding the fair presentation of cost statements. The cost auditor's opinion is expressed in the cost audit report. At this stage of the audit, a cost auditor will draw on their understanding of the client, their detailed knowledge of the risks faced by the client, and the conclusions drawn when testing the entity's controls, transactions, cost heads, item of cost and related disclosures.

1.2 AUDIT PROCESS

This is exhibited in figure; the user of this manual is required to have an understanding of all the SCAs to understand the below exhibited audit process.

Audit Process

Activity **Purpose** **Documentation**



1.3 PRACTICAL STEPS OF AUDIT PROCESS

The points given below summarize what a cost auditor does when he undertakes any cost audit:

Stage-I Steps – Objectives of Audit and Management Outlook [SCA 103]

- The audit is not for only for meeting with the statutory requirements but the management do have any other expectations or outcomes in its mind from the cost audit, such as
  - cost optimization or cost reduction
  - checking parameters of operational efficiency of a unit or any utility or any other function or department
  - suggesting product diversification or changed product-mix
  - identifying profit making or loss making products
  - suggesting changed marketing strategies; market expansion; market diversification
  - complete review of business strategies

Stage-II Steps – Pre-conditions

- The cost auditor should fully understand the
  - Objectives of cost audit
  - Area, nature and scope of audit
  - Number of cost auditors appointed
  - The applicable reporting framework
  - The reporting period
  - The statutory deadlines

- Do the Management understand its scope of work and responsibilities for
  - maintenance of cost records & producing them to the cost auditor;
  - preparation & presentation of cost statements & other details as per the applicable reporting framework, and in compliance with the cost accounting standards;
  - selection and consistent application of appropriate cost accounting policies;
  - allowing access to the auditor all information, including the books of accounts, vouchers, cost records, other records, documents, and other matters of the company, which are relevant to the preparation of the cost statements;
  - providing additional information that the cost auditor may request from the management for the purpose of cost audit;

- allowing unrestricted access to persons within the company from whom the cost auditor determines it is necessary to obtain cost audit evidence; and
- giving proper management representation.

- The auditee and the cost auditor decides the audit fee and payment schedule; and finally, the cost auditor gets an engagement letter.
- All these are called pre-conditions of audit.

Stage-III Steps – Understanding the Company's Business [SCA 104]

- The cost auditor is required to understand the company's business, its corporate structure and various systems followed.
- The company related details and other general details include
  - The company, its nature of activities, its size, product profile, unit locations, ownership structure, management structure, organisational structure, marketing set-up, accounting set-up, etc.
  - The nature of the industry or the sector in which client company operates
  - The applicable regulatory framework, financial reporting framework and cost reporting framework
  - The company's production process, product details, joint or by-products, outsourcing, if any
  - Details of subsidiaries, associates and joint ventures
  - Key personnel in all departments including in Finance, Accounts, Costing, IT, Administration, Production, Purchase, Sales, etc
  - Purchase policy, sales policy, pricing policy, export/import policy
  - Inventory receipt, storage, issue & pricing policies; physical verification system; inventory management system
  - Related parties and nature of transactions with them
  - Indirect tax structure, as applicable
- Internal Control Systems followed by the company
- Internal Audit System, its scope & adequacy of coverage as well as effectiveness
- Accounting systems & Policies followed by the company
- Cost Accounting System & Policies followed by the company
- Company's MIS system, risk identification & management system
- IT architecture followed for financial accounting and for cost accounting; IT policy, control checks, authorization checks; IT data security policy

- Previous auditor's report

Stage-IV Steps – Planning the Audit [SCA 101]

Planning the audit include

- Timing [dates] and duration [no. of days] of audit period; including plan to visit the unit(s)
- Level and number of audit personal to be deployed; including supervision and review of work done by the audit team
- Audit partner to be deployed; his expected days & dates
- Drawing up an overall audit plan and audit strategy – this will act as guide to the audit team
- Deciding the materiality levels & sampling levels
- Formulating appropriate audit procedures
    - Management Representation
    - Management Assertion
    - Test of Controls
    - Test of Details
    - Substantive procedures
    - Analytical procedures
- Formulating risk assessment strategies & procedures i.e. methodology to measure material misstatements
- Planning for discussions with key personnel of the company; previous cost auditor, statutory financial auditor, and internal auditor
- Key inputs for planning are
    - results of preliminary activities as specified above
    - knowledge from previous audits and other engagements with the company
    - knowledge of business
    - nature and scope of the audit
    - statutory deadlines and reporting format
    - relevant factors determining the direction of the audit efforts
    - nature, timing and extent of resources required for the audit
- Document the Audit Plan and share it with the company
- Ensure adherence to the Guidance Manual for Audit Quality

Stage-V Steps – Execution of Audit

- Perform the audit checks and procedures, as planned

- Collect all required audit evidence enabling the auditor to form his opinion
    - validate their relevance and reliability
    - check their accuracy, completeness and sufficiency
    - check the source and consistency
- Prepare draft observations & discuss with key management personnel
- Prepare final audit report

Stage-VI Steps – Audit Documentation [SCA 102]

- Document audit plan, audit strategy
- Document all working papers
- Document all the audit evidences
- Document draft observations and discussions
- Document final report
- Preserve all documents in a bound folder/file for the prescribed period

If we have to succeed in the globalized world, we have to enlarge the scope of Cost Audit to cover all aspects of Manufacturing and Services sector activities including healthcare and education.

----Dr. APJ Abdual Kalam

CHAPTER -2 OVERVIEW OF STANDARDS ONCOST AUDITING

The Companies (Cost Records and Audit) Rules 2014 [as amended from time to time] were notified by the Ministry of Corporate Affairs, Government of India in exercise of the powers conferred by section 148 of the Companies Act, 2013.

Sub-section (3) of section 148 prescribes that the auditor conducting the cost audit shall comply with the *cost auditing standards*. This proviso to be read with the following explanation:

Explanation—*For the purposes of this sub-section, the expression "cost auditing standards" mean such standards as are issued by the Institute of Cost Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.*

While formulating the Standards, the Cost Audit & Assurance Standards Board [CAASB] takes into consideration the applicable laws, usage and business environment prevailing in India. CAASB also takes into account the relevant provisions of Cost and Works Accountants Act, Rules and Regulations, Code of Professional Ethics, Cost Accounting Standards and other Statements issued by the Institute of the Cost Accountants of India. The Standards issued by the CAASB are aligned, to the extent possible, with other recognised Standards issued in India and prevailing International Practices. If a particular standard or any part thereof is inconsistent with a law, the provisions of the said law shall prevail.

Standards formulated by the CAASB include paragraphs in ***bold italic type*** and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. Each Standard should be read in the context of the objective stated in that Standard and the Preface to CAASB which is available on the Institute website. Any limitation on the applicability of a Standard is made clear in the Standard itself.

2.1 INTERNATIONALSTANDARDS ON AUDITING (ISAs) vis-à-vis STANDARDS ON COST AUDITING (SCAs)

The Institute of Cost Accountants of India is a founder member of the International Federation of Accountants (IFAC). The International Auditing and Assurance Standards Board (IAASB) established under the authority of IFAC have issued series of International Standards on Auditing (ISAs). These Standards have been widely acknowledged and adopted [with or without any modifications] by all professional Institutes across the world. As a founder member of IFAC, the Institute could have also adopted these Standards. However, as these Standards are primarily focussed on the financial audit; hence there was need to modify their content to the extent required.

It is a well-known fact that prima facie, the function of "Audit" per se do not differ in any audit assignment except for its 'scope' and the 'target clientele'. Broadly, the role & responsibility of an auditor, be it financial audit or cost audit, remains same. For all practical purposes and under provision of law, cost auditor has same rights, duties, and obligations as applicable to the financial auditor. Hence, even though the cost accounting differs from financial accounting, but the audit practice thereof does not differ. Therefore, Standards on Cost Auditing [SCAs] issued by the Institute are, in-principle, based on the International Standards on Auditing [ISAs] with suitable modifications in framework and content wherever found necessary.

As compared to the ISAs, following changes have been 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; and

3. Unlike the practice followed in ISAs, definitions of all 'terms' relevant to each SCA have been reproduced therein.

2.2 STRUCTURE OF STANDARDS ON COST AUDITING

SCA Elements	Particulars
Introduction	This part is an explanation of the purpose of the SCA, including the subject matter, specific expectation on the cost auditor and other, and the context in which particular SCA is set out.
Objectives	The objective to be achieved by the cost auditor as a result of complying with the requirements of the SCA. To achieve the overall objective of the cost auditor, the cost auditor is required to use the objective stated in relevant SCAs.
Scope	The scope in relation to respective standard set out the extent or area or subject matter that something deals with or to which it is relevant for cost auditor to comply requirements
Definitions	A description of meanings attributed to certain terms for the purpose of SCAs. These are provided to assist in consistent application and interpretation of the SCAs. These are not intended to override definitions that may be established for other purpose, such as those contain in laws or regulations. Unless otherwise indicated, these term carry the same meaning throughout the SCAs
Requirements	This section outlines the specific cost auditor requirements.Each requirement contains the word "shall". For example, SCA 101, Para 5.3, contains the following requirement: ***"The Cost Auditor shall formulate an Overall audit strategy that***

	sets the scope, timing, and direction of the audit."
Application Guidance	The application guidance provides further explanation of the requirements of SCA, and guidance for carrying them out. In particular, it may: • Explain more precisely what a requirement means or is intended to cover; • Where applicable, includes considerations &specific circumstances; and • Includes examples of procedures that may be appropriate in the circumstances. However, the actual procedures selected by the cost auditor require the use of professional judgment based on the particular circumstances of the entity and the assessed risks of material misstatement. While such guidance does not in itself impose a requirement, it is relevant for proper understanding of the requirements given in the Standard.
Effective Date	This part denotes the effective date for mandatory applicability of the Standard.
Statement of Modification	This part denotes material departure or addition from the International Standard on Auditing issued by the IAASB of IFAC.

2.3 OBJECTIVITY OF STANDARDS ON COST AUDITING

The objective of SCAs is to enable the cost auditor to achieve its overall audit objectives and ensuring the conduct of audit of cost statement in accordance with the principle set out therein with respect to the following.

- *To obtain reasonable assurance about whether the cost statement as a whole are free from material misstatement, whether due to error or fraud;*
- *To enable the cost auditor to express opinion whether the Cost Statements are prepared, in all material respects, in accordance with the applicable Cost reporting framework, Cost Accounting Standards(CAS) and Generally Accepted Cost Accounting Principles (GACAP);*
- *To give a true and fair view of the cost of production of a product, activity or service, cost of sales and margin;*
- *To report on the cost statements in the form required by law or by the CAS in accordance with the auditor's findings; and*
- *To qualify the opinion and in extreme cases disclaim an opinion, where reasonable assurance cannot be obtained.*

In order to achieve the overall objectives of audit as envisaged in SCA-103 "*Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards*", the requirementsare reproduced below.In brief, the cost auditor is required to comply with the requirements of SCA-103 in conjunction with all the requirements of other Standards on Cost Auditing (SCAs), Cost Accounting Standards (CASs), Generally Accepted Cost Accounting Principles (GACAP), applicable Laws and Regulations, Ethical and Moral Requirements, Code of Conduct, and Institute Guidelines for audit of cost statements.

2.4 OVERALL REQUIREMENTS OF STANDARDS ON COST AUDITING

☞ The cost auditor shall comply with the relevant ethical requirements including those pertaining to independence in respect of cost audit engagements.

☞ While conducting an audit, the cost auditor shall comply with each of the Cost Auditing Standards relevant to the audit. A Cost Auditing Standard is relevant to the audit when the Cost Auditing Standard is in effect and the circumstances addressed by the Cost Auditing Standard exist.

☞ The cost auditor shall have an understanding of the entire text of the Cost Auditing Standard, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.

☞ The cost auditor shall not represent compliance with the cost auditing standards in the cost auditor's report unless the auditor has complied fully with all of the Cost Auditing Standards relevant to the audit.

☞ In exceptional circumstances, the cost auditor may judge it necessary to depart from a relevant requirement in a Cost Auditing Standard. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement.

☞ The cost auditor shall plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the Cost Statements to be materially misstated.

☞ The auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.

☞ The cost auditor shall exercise professional judgment in planning and performing the audit.

☞ The cost auditor shall determine whether the Cost Reporting Framework followed by management in preparing cost statements is in line with the Companies Act and the Rules prescribed thereunder.

☞ The cost auditor shall not be required to perform audit procedures regarding the entity's compliance with laws and regulations governing cost audit in the absence of identified or suspected non-compliance.

☞ If an objective in a relevant Cost Auditing Standard cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the Cost Auditing Standards, to modify the auditor's opinion.

☞ The Cost Auditor shall ensure adherence to the relevant clauses of the Guidance Manual for Audit Quality issued by Quality Review Board (QRB) constituted u/s 29A of The Cost and Works Accountants Act 1959.

2.5 RESPONSIBILITY FOR COST STATEMENT

SCA -103**,** Para 6.5provide guidance for responsibility of cost statement as under:

The cost auditor is responsible for forming and expressing an opinion on the Cost Statements. However, the management or those charged with governance is responsible for preparation of cost statements.

The term "Cost Statements" refers to a structured representation of the cost information, which ordinarily includes accompanying notes, derived from cost accounting records and intended to communicate an entity's use of economic resources and the output obtained in accordance with a Cost reporting framework. The term can refer to for example, a cost statement, reconciliation with financial accounts and related explanatory notes.

(a) The requirements of the Cost reporting framework determine the form and content of the Cost Statements and what constitutes a complete set of Cost Statements. For certain Cost reporting frameworks, a single cost statement as such and the related explanatory notes constitute a complete set of Cost Statements. For example, a Cost Statement under Cost Accounting Standard-4.

(b) The Cost auditor is not responsible for preparing and presenting the cost statements in accordance with the applicable Cost reporting framework including inter-alia:

(1) Designing, implementing and maintaining internal control relevant to the preparation and presentation of Cost Statements that are free from material misstatement, whether due to fraud or error;

(2) Selecting and applying appropriate Cost accounting policies; and

(3) Making cost estimates that are reasonable in the circumstances.

2.6 STANDARDS ON COST AUDITING – A BRIEF SYNOPSIS

Before, a brief about the Standards on CostAuditing is given, it is emphasised that understanding of each Standard is necessary. Each word and sentence of the Standard should be read carefully. In the first instance, the user may feel that the language of the Standards is very difficult but reading again and again will help in understanding the intent of the Standard properly. In most of the cases, the cost audit is done by audit team comprising the professional and non- professionals. Hence, it is suggested that the Audit Team engaged for cost audit should familiarize and have proper understanding of the requirements of the Standards.

It is needless to mention that the Standards on Cost Auditing will help the cost auditors to plan, perform and to obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud or error, and to enable the cost auditor to express an opinion in accordance with the applicable Cost reporting framework, Cost Accounting Standards(CAS) and Generally Accepted Cost Accounting Principles (GACAP) as issued by the Institute, and give a true and fair view of the cost of a product, activity or service.

2.6.1 SCA 101- Planning an Audit of Cost Statements

Planning an audit of cost statements, records and other related documents is considered necessary to ensure achievement of audit objectives with available resources and securing coordination with the auditee on audit work. Planning also helps the cost auditor to perform the audit in an efficient and effective manner. Audit planning shall also include establishing the overall audit strategy and audit plan for the conduct of the audit.

Before planning, the cost auditor is to ensure that his appointment as auditor is proper and the legal formalities, ethical requirements, understanding of the terms of reference including the units to be covered, products/services to be covered, and scope of coverage have been properly understood by him.

The nature and extent of planning activities will vary according to (a) size and complexity of the entity's activities, the number of products to be covered, the processes and operations involved; (b) the audit team members' previous experience with the entity and the industry and (c) changes in circumstances that occur during the audit.

Planning also helps the cost auditor in the risk assessment procedures. However, planning the nature, timing and extent of specific further audit procedures depend on the outcome of those risk assessment procedures.

2.6.2 SCA 102- Cost Audit Documentation

In order to have proper evidence that the audit was planned and performed in accordance with Standards on Cost Auditing and applicable legal & regulatory requirements, documentation is very much necessary for the cost auditor. The Standards prescribe that the Cost Auditor shall prepare audit documentation that is sufficient to enable another competent person, having no previous connection with the said audit, including person undertaking peer review to understand:

(a) Conformance of audit procedures performed with legal and regulatory requirements;

(b) Conformance to Standards on Cost Auditing;

(c) The results of audit procedures performed;

(d) The audit evidence obtained;

(e) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

The Cost Audit documentation will usually contain:

(i) **Checklists; Example**: Checklist of compliance with:-

  (a) The Rules, regarding maintenance of Cost Records, as prescribed under the Companies Act,

  (b) The Cost Accounting Standards (CAS) as prescribed by the Institute,

  (c) The Generally Accepted Cost Accounting Principles (GACAP) as prescribed by the Institute

(ii) **Audit programs:** Example: Audit Program for Material Cost, Employee Cost and others.

(iii) **Analysis:** Cost Audit relies more on analytical review than on substantive testing to establish true and fair view. Example: Calorific value of different fuels used and average Cost per unit of calorific value and Specific Heat Consumption.

(iv) **Audit Query List:** Contains a log of audit queries raised and their resolution.

(v) **Abstracts of significant contracts relating to costs and revenues:** Example: Supply of materials indicating price, quality terms, O & M contracts, Terms of supply of contract labour and others.

(vi) **Letters of confirmation:** Example: Stock of materials with subcontractors.

(vii) **Letter of Representation from Management Correspondence (including e-mail) concerning significant matters.** Example: Correspondence regarding terms of supply of goods and services.

(viii) **Abstract or copies of the entity's records**

2.6.3 SCA 103-Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

This Standard deal with the overall objectives of the independent cost auditor, the nature and scope of a cost audit, the independent auditor's overall responsibilities when conducting an audit of cost statements in accordance with Standards on Cost Auditing. The cost auditor is required to obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud or error, and to enable the auditor to express an opinion whether the Cost Statements are prepared, in all material respects, in accordance with the applicable Cost reporting framework, Standards on Cost Accounting (SCAs) and Generally Accepted Cost Accounting Principles (GACAP) as issued by the Institute of the Cost Accountants of India, and give a true and fair view of the cost of a product, activity or service. Standard mentions that "*the provision of services for maintenance of cost records, design and implementation of Cost Systems and internal audit are considered to erode the independence of cost auditor*".

Further, the cost auditor is to report on the cost statements in the form required by law or by the Cost Auditing Standards in accordance with the auditor's findings. Where reasonable assurance cannot be obtained, the cost auditor should qualify the opinion and in extreme cases disclaim an opinion. The Cost Auditors objective may extend to making observations and suggestions where required by applicable regulations.

A cost auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the cost auditor's ability to detect material misstatements. These limitations result from factors such as:

(1)the use of sample testing;

(2)the inherent limitations of internal control (for example, the possibility of management override or collusion); and

(3 the fact that most audit evidence is persuasive rather than conclusive.

Also, the work undertaken by the cost auditor to form an audit opinion is permeated by judgment, regarding:

(1) *the gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and*

(2) the drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management in preparing the Cost Statements.

The cost auditor shall exercise professional judgment in planning and performing the audit. The cost auditor shall plan and perform an audit with an attitude of professional scepticism.

2.6.4 SCA 104- Knowledge of Business, its Processes and the Business Environment

In performing an audit of cost statement, cost records, and other related documents, the cost auditor should have the knowledge of the client's business to enable him to understand the processes and express his opinion on the cost statements.

The cost auditor's level of knowledge for a cost audit engagement should include a general knowledge of the economy and the industry within which the entity operates, and a more particular knowledge of how the entity operates.

The cost auditor should obtain an understanding of the following:

(a) *The nature of the entity, (including its operations covering Business processes, major inputs, Joint & By-Products and Wastages and major outputs etc) and the entity's ownership and governance structure.*

(b) *Relevant industry, regulatory, and other external factors including the applicable cost and financial reporting framework.*

(c) *The entity's selection and application of cost accounting policies.*

(d) *The measurement and review of the entity's performance.*

In addition to above, the cost auditor is also required to obtain an understanding of internal controls, control environment, risk assessment process, identifying business risks, assessing the likelihood of their occurrence, estimating the significance of the risks and deciding about actions to address those risks relevant to the audit. He shall also understand the IT (Information Technology) environment and control system of the entity.

2.6.5 SCA 105- Agreeing the Terms of Cost Audit Engagements

This Standard deals with the cost auditor's responsibilities in agreeing the terms of cost audit engagement with the management. This includes establishing that certain preconditions for cost audit rest with management. This standard deals with those aspects of engagement acceptance that are within the control of the cost auditor.

In order to establish whether the preconditions for cost audit are present, the cost auditor shall:

(a) Determine whether the cost reporting framework to be applied in the preparation of the cost statements is acceptable; and

(b) Obtain the agreement from management that it acknowledges and understands its responsibility:

i) For preparation and presentation of cost statements in accordance with applicable cost reporting framework that gives true and fair view of cost of production or cost of operations, cost of sales, and margin for each product or service or activity, produced or provided by the entity for the period under audit;

ii) For selection and consistent application of appropriate cost accounting policies;

iii) For implementation of cost accounting standards issued by the Institute, along with proper explanation relating to any material departures from those cost accounting standards;

iv) For such internal control as management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error; and

v) To provide the Cost Auditor with:

a) Access, at all times, to all information, including the books of accounts, vouchers, cost records, other records, documents, and other matters of the company, whether kept at the head office of the company or elsewhere, of which management is aware that is relevant to the preparation of the cost statements;

b) Additional information that the cost auditor may request from management for the purpose of the cost audit; and

c) Unrestricted access to persons within the entity from whom the cost auditor determines it is necessary to obtain cost audit evidence.

2.6.6 SCA 106- Audit Sampling

This standard provides guidance on the use of audit sampling and other means of selecting items for testing the samples from the large population when designing the cost audit procedures to gather audit evidence in performing cost audit. It also provides the pre-requirements for the use of audit sampling methods i.e. statistical and non-statistical sampling and practical application guidance on selection of audit sample from large population, performing test of controls and tests of details to develop reasonable basis for cost auditor to draw conclusions and evaluation of results derived from the audit sampling.

"***Audit Sampling***" is an application of audit procedure to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the Cost Auditor a reasonable basis to draw conclusions about the entire population.

"***Population***" is the entire set of data from which a sample is selected and about which the cost auditor wishes to draw conclusions.

"***Stratification***" is the process of dividing a population into sub-population, each of which is a group of sampling units which have similar characteristics (often monetary value).

The requirements of this Standard is to consider purpose of the cost audit procedures and the characteristics of population, sample size, selection of audit sampling, evaluation of audit sampling, tolerable rate of deviation, tolerable misstatement, designing of test of control and test of details and stratification. This standard also explains that if the cost auditor is unable to apply the designated cost audit procedures, or suitable alternative procedures to a selected item, the cost auditor shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details. The cost auditor shall also ensure that use of audit sampling has provided a reasonable basis for conclusions about the population tested and thereby shall evaluate the results derived from sample tested.

This Standard also provides appendices to enable the cost auditor to select samples on the basis of principal methods i.e. random selection, systematic selection, monetary unit sampling, haphazard selection and block selection.

2.6.7 SCA 107- Audit Evidence

The objective of this standard is to enable the cost auditor to design and perform cost audit procedure in such a way to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusion on which cost auditor's opinion is based.

"Sufficiency (of audit evidence)" is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the cost auditor's assessment of the risk of material misstatement and also by the quality of such audit evidence.

The cost auditor shall determine means of selecting items for testing that are effective in meeting the purpose of cost audit procedures, when designing tests of controls and tests of details for obtaining audit evidence.

Audit evidence to draw reasonable conclusions that is used by the cost auditor to form his opinion, is obtained by performing:

(i) Risk assessment procedures; and
(ii) Further cost audit procedures, which comprise:
   a) Tests of controls, and
   b) Substantive procedures, including tests of details and substantive analytical procedures.

This Standard also requires that cost auditor shall ensure the relevance and reliability of information gathered internally or produced by management's expert(s) to obtain sufficient appropriate audit evidence.

***Substantive procedures** are intended to create evidence that an auditor assembles to support the assertion that there are no material misstatements in regard to the completeness, validity, and accuracy of the cost records of an entity. Thus, substantive procedures are performed by an auditor to detect whether there are any material misstatements in transactions. It comprises of:*

(i) Tests of details (of classes of transactions, account balances, and disclosures); and
(ii) *Substantive analytical procedures.*

2.6.8 SCA 108- Materiality in Planning and Performing a Cost Audit

This Standard deals with the cost auditor’s responsibility to apply the concept of materiality in planning and performing audit of cost statements, cost records and other related documents. This Standard explains how materiality is applied in evaluating the effect of identified misstatement on the cost audit and of uncorrected misstatement, if any, on the cost statements, cost records and other related documents.

The cost auditor’s determination of materiality is a matter of professional judgment, and is affected by the cost auditor’s perception of the cost information needs of users of the cost statements.

The concept of materiality is applied by the cost auditor both in planning and performing the cost audit, and in evaluating the effect of identified misstatements on the cost statements and in forming the opinion in the cost auditor’s report.

The cost auditor shall revise the established materiality level or levels for the cost statements as a whole (and, if applicable, the materiality level or levels for particular items of cost) in the event of becoming aware during the audit that would have caused the cost auditor to have determined different level or levels initially.

2.6.9 SCA 109- Cost Auditor’s Responsibility relating to Fraud in an Audit of Cost Statements

This Standard deals with the cost auditor’s responsibilities in understanding, and differentiating misstatements with fraud, its detection, and reporting it to the concerned authorities in case any fraud is detected in the audit of cost statements.The primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the entity.

A cost auditor conducting an audit in accordance with Standards on Cost Auditing is responsible for obtaining reasonable assurance that the cost statements taken as a whole are free from material misstatement, either caused by error or fraud. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the cost statements may not be detected; even though the audit is properly planned and performed in accordance with the Standards on Cost Auditing.

When obtaining reasonable assurance, the cost auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this Standard on Cost Auditing are designed to assist the cost auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

2.6.10 SCA 110- Written Representations

This Standard provides guidance to obtain written representations from management as audit evidence, the procedures to be applied in evaluating and documenting written representation, and the actions to be taken if management refuses to provide appropriate representations.

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the cost auditor obtains about the fulfilment of management's responsibilities, or about specific assertions.

The cost auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the cost statements in accordance with the applicable cost reporting framework, including, where relevant, their true and fair presentation, as set out in the terms of the cost audit engagement. Management written representation provides that "*It has provided the cost auditor with all relevant information and access as agreed in the terms of the cost audit engagement; and all transactions have been recorded and are reflected in the cost statements*".

2.6.11 SCA 111- Evaluation of Misstatements identified during the Cost Audit

This Standard assists the cost auditor in evaluating the misstatements identified during the audit. The Standard requires cost auditor to assess whether an individual misstatement or aggregate of misstatements approaches materiality; if so, communicate the same with management for appropriate correction; evaluate the effect of uncorrected misstatements; communicate with those charged with governance; and appropriately document the conclusions and the basis for arriving at the conclusions.

Misstatements may result from:

(a) An inaccuracy in gathering, classifying and /or processing data from which the cost statements are prepared;

(b) *An omission;*

(c) *An incorrect costing estimate arising from overlooking, or clear misinterpretation of, facts; and*

(d) *Judgments of management on cost estimates that the cost auditor considers unreasonable or the selection and application of costing principles, methods, and policies that the cost auditor considers inappropriate.*

The correction by management of all misstatements, including those communicated by the cost auditor, enables management to maintain accurate cost records and reduces the risks of material misstatement in future cost statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.

2.6.12 SCA 112- Analytical Procedures

This Standard deals with the cost auditor's use of analytical procedures as substantive procedures. It also deals with the cost auditor's responsibility to perform analytical procedures near the end of the audit that assist the cost auditor when forming an overall opinion on the cost statements, in risk assessment and guidance regarding the nature, timing and extent of audit procedures in response to assessed risks.

When designing and performing substantive analytical procedures, either alone or in combination with test of details, the cost auditor shall:

(a) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;

(b) Evaluate the reliability of cost data from which the cost auditor's expectation of recorded amounts or ratios are developed, taking account of source, comparability, and nature and relevance of cost information available, and controls over preparation;

(c) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the cost statements to be materially misstated; and

(d) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

Analytical procedures include the consideration of comparisons of the entity's cost information with, for example:

(a) Comparable cost information for previous years or periods.

(b) Anticipated results of the entity, such as cost of production / operation, input – output norms of major items of cost, etc.

(c) Similar industry consumption norms or with industry averages of major items of cost or cost of goods sold or with other entities of comparable size in the same industry.

2.6.13 SCA-113 - Using the Work of Internal Auditor

The objectives of this Standard, where the entity has an internal audit function and cost auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent of audit procedures to be performed directly by the cost auditor, or to use internal auditor to provide direct assistance, are:

(a) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent; and having made that determination:

(b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and

(c) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work.

It is choice of the cost auditor to use the work of internal auditor. If he uses, it will help him to modify the nature or timing, or reduce the extent of audit procedures to be performed directly by the cost auditor.It remains a decision of the cost auditor in establishing the overall cost audit strategy.

The cost auditor shall not use an internal auditor to provide direct assistance if:

(a) There are significant threats to the objectivity of the internal auditor; or
(b) The internal auditor lacks sufficient competence to perform the proposed work.

Objectivity refers to the ability to perform tasks without allowing bias, conflict of interest or undue influences of other factors that may affect the cost auditor's evaluation.

2.6.14 SCA 114- Using the Work of a Cost Auditor's Expert

During the cost audit, cost auditor may encounter complex or subjective matters which are potentially material to the audit of cost statements. Such matters may require special skill or knowledge. This Standard deals with the cost auditor's responsibilities regarding the use of an individual or organization's work in a field of expertise other than accounting or auditing, when that work is used to assist the cost auditor in obtaining sufficient appropriate audit evidence.

The cost auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by use of the work of cost auditor's expert. The cost auditor is to determine whether the work of that expert is adequate for the cost auditor's purposes. If yes, the cost auditor may accept that expert's findings or conclusions in the expert's field as appropriate audit evidence.

Expertise in a field other than accounting or auditing may include expertise in relation to such matters as:

(a) Determination of installed/ achievable capacity of plant, machineries, process, product etc.

(b) Determination and or verification of consumption norms of various inputs like material, labour, machine hours, technical standards.

(c) Impact on consumption norms of various inputs due to change in production process, change in technology, or substitute of major input material(s).

(d) Efficiency of machines, boiler etc. which has significant impact on determination of machine hour rate, labour hour rate and or utilities consumption pattern.

(e) The interpretation of contracts, laws, and regulations.

(f) The analysis of complex or unusual tax compliance issues.

2.6.15 SCA 115- Communication with Those Charged with Governance

This Standard focuses primarily on communications from the cost auditor to those charged with governance.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 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

(c) To promote effective two-way communication between cost auditor and those charged with governance.

Effective two-way communication assists the cost auditor and those charged with governance in understanding matters related to the audit, and in developing a constructive working relationship. 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.

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 with 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.

2.6.16 SCA 116- Communicating Deficiencies in Internal Controls to Those charged with Governance and Management

The purpose of this Standard is to establish requirements and explains that the cost auditor is required to obtain an understanding of internal controls relevant to the audit when identifying and assessing the risks of material misstatement. In making those risk assessments, the cost auditor considers internal controls in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal controls. The cost auditor may identify deficiencies in internal controls not only during the risk assessment process but also at any other stage of the audit. This SCA specifies which identified deficiencies the cost auditor is required to communicate to those charged with governance and management.

This Standard does not impose additional responsibilities on the cost auditor regarding obtaining an understanding of internal controls and designing and performing tests of controls over and above the requirements of Standards on Cost Auditing.

Examples of matters that the cost auditor may consider in determining whether a deficiency or combination of deficiencies in internal controls constitutes a significant deficiency include:

(a) The likelihood of the deficiencies leading to material misstatements in the measurement, classification, allocation, apportionment, and absorption of costs.

(b) The susceptibility to loss or fraud relating to misappropriation of assets or over-valuation or under-valuation of inventories.

(c) The subjectivity and complexity in determining the quantity or value of consumption of raw materials, utilities and other inputs effecting true and fair value of cost of production or operations, cost of sales and margin for each product or service.

(d) The volume of activity that has occurred or could occur in the items of cost exposed to the deficiency or deficiencies.

(e) The importance of the controls to the cost reporting framework;

(f) The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.

(g) *The interaction of the deficiency with other deficiencies in internal control*.

2.6.17 SCA 117- Cost Auditor's Responses to Assessed Risks

The cost auditor performs risk assessment procedures, which include obtaining an understanding of entity, its control environment, its risk assessment process; undertake inquiries of management, observation, inspection of relevant documents; and perform analytical procedures to assess risks of material misstatements at cost statement level and at assertion level. After assessing the risks, the cost auditor is to design and implement audit procedures responsive to the assessed risks of material misstatement and evaluate whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level.

This Standard establishes requirements and provides application and other explanatory material regarding the auditor’s responsibility to design and implement responses to the assessed risks of material misstatement in audit of cost statements.

The cost auditor may have designed specific tests of controls for some risk assessment procedures as they provide audit evidence about the operating effectiveness of the controls and, consequently, serve as tests of controls. For example, the cost auditor’s risk assessment procedures may have included:

(a) Inquiring about management’s use of standards or budgets;

(b) Observing management’s comparison of monthly budgets or standard and actuals with respect to expenses & consumption quantities for items such as consumption of material, utilities, labour etc;

(c) Inspecting reports pertaining to the investigation of variances between budgets/ standards and actuals; and

(d) These audit procedures provide knowledge about the design of the entity’s budgeting policies and whether they have been implemented, but may also provide audit evidence about the effectiveness of the operation of budgeting policies in preventing or detecting material misstatements in the classification of expenses.

2.6.18 SCA 118- Identifying and Assessing the Risks of Material Misstatement

An understanding of the entity and its control activities relevant to audit, including internal control, establishes a frame of reference within which the cost auditor plans the audit and exercises professional judgment throughout the audit, particularly when assessing risks of material misstatement, determining materiality, considering the appropriateness of the selection and application of cost accounting policies, identifying areas where special audit consideration may be necessary (for example related party transactions), responding to the assessed risks of material misstatement, obtain sufficient appropriate audit evidence, etc.

This Standard describes the audit procedures to identify and assess the risk of material misstatements and control activities relevant to the cost audit so that information obtained by performing such risk assessment procedures and related activities may be used by the cost auditor as audit evidence to support assessments of the risks of material misstatement.

The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the cost statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

2.6.19 SCA 119- Related Parties

The purpose of this Standard is to establish requirement to assist the cost auditor in identifying and assessing the risks of material misstatement associated with related party relationship and transactions, and in designing cost audit procedures to respond to the assessed risk associated with such related parties.

Related party transactions are also done in the ordinary course of business. In such circumstances, they may carry no higher risk of material misstatement of the cost statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the cost statements than transactions with unrelated parties. For example:

(a) Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.

(b) Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.

(c) Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Because related parties are not independent of each other, many cost reporting frameworks establish specific cost accounting policies and disclosure requirements for related party relationships, transactions and balances to enable users of the cost statements to understand their nature and actual or potential effects on the cost statements. Where the applicable cost reporting framework establishes such requirements, the cost auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the cost reporting framework.

Even if the applicable cost reporting framework establishes minimal or no related party requirements, the cost auditor nevertheless needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the cost statements, insofar as they are affected by those relationships and transactions:

(i) Achieve a true and fair presentation; and
(ii) Are not misleading.

In addition, an understanding of the entity's related party relationships and transactions is relevant to the cost auditor's evaluation of whether one or more fraud risk factors are present because fraud may be more easily committed through related parties.

2.7 CONCLUSION

The brief of the above Standards on Cost Auditing would provide the insight to readers about the contents contained in these Standards. The above brief does not supplement the proficiency which is very much required by the cost auditors and audit team engaged for audit of cost records, cost statements and related documents of an entity. The audit as per the Standards would provide quality audit and would also assist the cost auditor a step towards the requirements of "Peer Review" which is not intended to find out the deficiencies in the working of professionals but to improve the quality of work performed by them. In addition to above Standards, the readers are requested to read "***Guidance Manual for Audit Quality***" which is a significant attempt to improve the quality of the CMA professionals.

Perfection is not attainable, but if we chase perfection, we can catch excellence.

....By Vince Lombardi

CHAPTER –3 KEY DEFINITIONS

This chapter provides an understanding about the definitions given under SCAs and other relevant definitions that provide inherent application of such concepts in audit of cost statements. Few important definitions are explained in this chapter enabling the cost auditor to thoroughly understand the requirements of SCAs.

However, some of the relevant definitions are explained in more detail in related chapter for better understanding of concept and application respectively.

3.1 EXPLANATION

3.1.1 Assertions—*Representations by management, explicit or otherwise, that areembodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.*

Assertions in the Audit of Cost Statements

Audit Assertions are the implicit or explicit claims and representations made by the management responsible for the preparation of cost statements regarding the appropriateness of the various elements of cost statements and disclosures. Types are:

- Occurrence - Costs recognized in the cost statements have occurred and relate to the entity.
- Completeness - All costs that were supposed to be recorded have been recognized in the cost statements.
- Accuracy - Costs have been recorded accurately at their appropriate amounts.
- Cut-off - Costs have been recognized in the correct accounting periods.
- Measurement - Costs have been correctly measured as per the applicable Standards.
- Classification - Costs have been classified and presented fairly in the cost statements.
- Presentation & Disclosure - Costs have been correctly disclosed as per the applicable cost reporting framework.

3.1.2 Performance Materiality

Performance Materiality means materiality level or levels set by the cost auditor for the cost statements as a whole or for particular items of cost, to reduce the audit risk.

According to **SCA 108,***'A matter is material if its omission or misstatement would reasonably influence the economic decisions of users taken on the basis of the cost statements.'*

Performance materiality as the level or amounts set by the cost auditor at less than materiality for the cost statements as a whole or particular items of cost to reduce the audit risk to an appropriately low level, the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the cost statements as a whole. If applicable, performance materiality also refers to the materiality level(s) set by the cost auditor at less than the materiality level or levels for particular items of cost, cost head or disclosures.

During the planning process, the cost auditors will review the information they have obtained about the entity's operational results for the period and make a preliminary estimate of materiality for the cost statements as a whole. They will also look at particular item of cost, for example BOM Cost, Production Overheads, etc. and make an estimate of what they would consider to be a material misstatement for that item of cost. However, during the actual audit work, the cost auditors will set performance materiality at a lower level of materiality than they had during the planning stage, i.e. smaller items now become material. The levels of planned materiality and performance materiality should be constantly reviewed during the audit and revised as appropriate.

SCA-108, also enumerates the concept of materiality and its determination and application in context of cost audit. This is summarized below:

The cost auditor's determination of materiality is a matter of professional judgment, and is affected by the cost auditor's perception of the cost information needs of users of the cost statements. In this context, it is reasonable for the cost auditor to assume that users:

- Have a reasonable knowledge of business and economic activities and willingness to conduct the audit of cost statements with reasonable diligence.
- Recognize the uncertainties inherent in the measurement of cost based on the use of estimates, judgement and consideration of event taken place.
- Make reasonable decisions on the basis of the information gathered and available.
- Use of benchmark in determining materiality for cost statements as a whole.
- Revision of materiality level as the cost audit progresses.

Calculation of materiality level at cost statement level

The arrival at a materiality level for the cost statements as a whole is, again, dependent on the cost auditor's professional judgement. However, over the years there has been a customary practice to apply percentages to certain areas of the cost statements and use those in arriving at a cost statement materiality level. For example:

- 1⁄2 to 1% of turnover / BOM cost
- 1 to 2% of gross assets (balance sheet total))
- I to 2% of Cost of production/ Cost of Goods sold before tax
- 2 to 3% of gross or net contribution

The use of percentage amounts in arriving at a cost statement materiality level is not prescriptive and the benchmarks above are given as a guideline only. Alternative methods of calculating cost statement materiality may well be more appropriate as no two audits will be the same. Depending on the levels of risk, the cost auditor may determine that the above calculations give too a high a materiality level and will therefore either reduce the percentages accordingly (depending on their past experience and risk assessment) or may apply a completely different way of arriving at a cost statement materiality altogether.

3.1.3 Professional Judgement

Professional Judgement: The application of relevant training, knowledge, experience and objectivity, within the context provided by cost auditing standards, cost accounting standards and ethical requirements, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

The professional judgement is very essential to the proper audit of a cost statement. This is because interpretation of relevant ethical requirements and the requirements to comply with the principles enshrined in the Standards on Cost Auditing and the informed decisions required throughout the cost audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances.

Professional Judgement is necessary in particular regarding decision about:

- Materiality and audit risk.
- The nature, timing and extent of audit procedures used to meet the requirements of the SCAs and gather audit evidence.
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the overall objectives of cost auditor(s).
- The evaluation of management’s judgements in applying the entity’s applicable cost reporting framework.

- The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the cost estimates made by management in preparing the cost statements as whole.

3.1.4 Audit Risk

Audit risk is the risk that the cost auditor expresses an inappropriate audit opinion on the cost statements that are materially misstated. Audit risk is a function of the risk of material misstatement and detection risk.

(a) The risk of material misstatement has two components viz. Inherent Risk and Control risk.

(1) Inherent risk: the susceptibility of an assertion about the measurement, assignment or disclosure of cost to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

(2) Control risk: the risk that a misstatement that could occur in an assertion about the measurement, assignment or disclosure of cost and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal, operational and management control.

(b) Detection risk: the risk that the procedures followed by the cost auditor to reduce audit risk to an acceptable low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

Audit Risk is the risk of expressing an inappropriate audit opinion on cost statements that are materially misstated. The objective of audit is to reduce this risk to an acceptably low level. The cost auditors may certify that the cost statements give a true and fair view when they actually do not exists in letter and spirit. In other words the cost statements contain a significant error or misstatement which the cost auditor(s) have failed to detect.

Audit Risk = Inherent Risk x Control Risk x Detection Risk

Audit risk is a function of the risk of material misstatement and detection risk. The risk of material misstatement has two components viz. Inherent Risk and Control risk.

- Inherent Risk is the risk of a material misstatement in the cost statements arising due to error or omission as a result of factors other than the failure of internal controls, such as
  - Totalling mistake
  - Mistake to correctly carry the opening balances

  - Failure to account for all expenses relating to the year
  - Wrong assessment of capacity

- Control Risk is the risk of a material misstatement in the cost statements arising due to absence or failure in the operation of relevant internal controls of the entity, such as

  - Failure to perform supervisory or authentication checks
  - Failure to verify the veracity & accuracy of information
  - Failure to control frauds [fake staff bills, fake production, fake sales, fake consumption,

- Detection Risk is the risk that the auditors fail to detect a material misstatement in the cost statements.

Cost auditor must apply audit procedures to detect material misstatements in the cost statements whether due to fraud or error. To reduce audit risk to an acceptably low level, the cost auditor is required to:

- Assess the risks of material misstatement;

- Limit detection risk. This may be achieved by performing procedures that respond to the assessed risks of material misstatement, both at the cost statement level and at the assertion level for cost heads, items of cost, and disclosures;

- Inherent risk assessment should be made before the commencement of the audit of cost statements to ensure that the existence of a material misstatement either individually or when aggregated with other misstatements is detected and also an assurance to the satisfaction of the auditor derived that it is nil or acceptable to a lower level so as not to distort the cost statements significantly;

- The cost auditor should assess the controls prevailing at various levels to ensure and satisfy that the operating and financial controls are adequate and acceptable;

- Study the reports of the Internal Auditors, Statutory Auditors and other agencies being engaged by the Company and address the scope, nature and depth of audit procedures to be applied to perform his duties efficiently as a cost auditor;

- As far as the risk assessment is concerned, the engagement partner should directly involve himself together with team who will involve in the audit. This is essential because, while conducting the enquiries about the control aspects, the officials of the auditee at various levels may fail to provide complete information. It is the efficiency of the auditor to bring out the details to his satisfaction so as to frame the appropriate mind-set and opinion in determining the depth of the audit to be undertaken in each of the audit environment concerned.

Based on the above, the partner/ proprietor of the firm should plan the time schedule to complete the risk assessment as this forms the foundation of the whole audit completion.

3.2 RISK AT THE ASSERTION LEVEL

The term 'assertion' means what management have asserted to be true. For example, management will say (at the cost statement assertion level) that all item of cost / consumption / overhead that should have been recorded, have been recorded. An assertion is therefore made by management and it is up to the cost auditor to corroborate this assertion by way of audit evidence.

3.3 RISK ASSESSMENT

The purpose of risk assessment procedures is to identify and assess risks of material misstatement. This is achieved through understanding the entity and its environment, including internal control. Information may be obtained from external sources, such as the industrial benchmarking data and trade publications, and from internal sources such as discussions with key personnel. This understanding of the entity becomes a continuous, dynamic process of gathering, updating and analyzing information throughout the cost audit.

Risk assessment procedures provide audit evidence to support the assessment of risks at the cost statement and assertion levels. However, this evidence does not stand alone. Evidence obtained from risk assessment procedures is supplemented by further cost audit procedures (that respond to the risks identified) such as tests of controls and/or substantive procedures. The cost auditor uses professional judgment to determine the risk assessment procedures to be performed, and the scope or depth of understanding of the entity that is required.

The three risk assessment procedures:

(a) Inquiries of management and others
(b) Observation and Inspection
(c) Analytical Procedures

Changes due to circumstances can change the level of risk and may cause higher risk to controls which may leads to significant risks to cost reporting framework such as the followings:

- *Change in operating environment:* Changes in the regulatory or the operating environment can result in changes in competitive pressures and significantly different risks.

- *New personnel:* New personnel may have different focus on or understanding of internal control.

- *Rapid growth:* Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.

- *New Technology:* Incorporating new technologies into production processes or information systems may change the risk associated with control activities.

- *New business models, products, or activities:* Entering into business areas or transactions with which an entity has little experience may introduce new risk associated with controls.

- *Corporate Restructuring:* Restructuring may be accompanied by diversification, business integration, process integration and changes in supervision or segregation of duties that may change the risk associated with control functions.

- *Expanded foreign operations:* The expansion or acquisition of foreign operations carries new and often unique risk that may affect controls, for example transfer pricing issues.

- *New cost accounting pronouncements:* Adoption of new cost accounting or changing cost accounting principles may affect the risks in preparing cost statements.

3.4 OTHER KEY DEFINITIONS

3.4.1 Audit:*Audit is an independent examination of financial, cost and other related information of an entity whether profit oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.*

3.4.2 Audit Partner:*Audit partner means the partner in the firm who is a member of the Institute of Cost Accountants of India and is in full time practice and is responsible for the audit and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.*

3.4.3 Audit Team*:Audit team means all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.*

3.4.4 Auditee:*Auditee means a company or any other entity for which cost audit is being carried out.*

3.4.5 Auditor:*Auditor is used to refer to the person or persons conducting the audit, usually the audit partner or other member of the audit team, or, as applicable the firm. Auditor includes Cost Auditor.*

3.4.6 Cost Audit*:Cost audit is an independent examination of cost statements, cost records and other related information of an entity including a non-profit entity, when such an examination is conducted with a view to expressing an opinion thereon.*

3.4.7 Cost Auditor:*"Cost Auditor" means an auditor appointed to conduct an audit of cost records and shall be a cost accountant within the meaning of The Cost and Works Accountants Act 1959. "Cost Accountant" is a cost accountant as defined in clause (b) of sub-section (1) of section 2 of The Cost and Works Accountants Act, 1959 (23 of 1959) and who holds a valid certificate of practice under subsection (1) of section 6 and who is deemed to be in practice under subsection (2) of section 2 of that Act and includes a firm of cost accountants.*

3.4.8 Cost Audit Report:*Cost Audit Report means the report duly audited and signed by the cost auditor on an independent examination of the cost statements, cost records and other related information of an entity including a non-profit entity, expressing his opinion thereon. It includes any statement, qualifications, observations, etc. attached to the cost audit report, or that is required by law or regulation.*

3.4.9 Cost Records:*Cost Records means books of accounts relating to utilization of materials, labour and other items of cost, to facilitate calculation of true and fair cost of production or cost of operations, cost of sales, and margin for each product or service or activity, produced or provided by an entity including a non-profit entity, for any period, in compliance with Cost Accounting Standards issued by the Institute of Cost Accountants of India.*

3.4.10 Cost Reporting Framework:*Cost Reporting Framework means the framework adopted by the management and, where appropriate, by those charged with governance, in the preparation of the cost statements that is acceptable in view of the nature of the entity and the objective of the cost report, or that is required by law or regulation.*

3.4.11 Cost Statements:*Cost Statements, in relation to an entity, includes plant-wise, factory- wise or service centre-wise;*

- *i) quantitative details of capacity, production , trade purchases, sales and stocks;*
- *ii) quantitative, rates and value details of consumption of materials, utilities and other inputs;*
- *iii) cost sheet showing element-wise, total as well as per unit cost of production of goods or provision of services, cost of sales and margin for each product or service;*
- *iv) reconciliation of profits, or in case of an entity carrying on any activity not for profit, of surplus, as per cost accounts and as per financial accounts;*
- *v) reconciliation of indirect taxes showing details of total clearance of goods / services, assessable value, duties/ taxes paid, CENVAT or VAT or Service Tax credit utilized, duties / taxes recovered and interest / penalty paid;*
- *vi) statement of value addition and distribution of earnings;*

vii) *details of purchases and sales of goods and services with related parties showing transfer price vis-à-vis normal price; and*

viii) *any explanatory note annexed to, or forming part of, any document referred to in (i) to (vii) above.*

3.4.12 Emphasis of Matter paragraph: *A paragraph included in the cost auditor's report that refers to a matter appropriately presented or disclosed in the cost statements that, in the cost auditor's judgment, is of such importance that it is fundamental to users' understanding of the cost statements.*

3.4.13 Firm: *Firm means a sole practitioner, partnership including LLP(Limited Liability Partnership)or any other entity of professional cost accountants as may be permitted by law and constituted under The Cost and Works Accountants Act & Regulations.*

3.4.14 Initial Audit: *Initial audit means an audit where:-*

(a) The entity is subject to audit for the first time, as per the applicable laws, or
(b) The audit of the entity for the prior period was conducted by a different audit firm.

3.4.15 Internal Audit Function: *A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management, and internal control processes.*

3.4.16 Non-compliance: *Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations governing Cost Accounting, Cost Records and Cost Audit. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.*

"People forget how fast you did a job- but they remember how well you did it"

.....By Howard Newton

CHAPTER – 4 KNOWLEDGE OF BUSINESS, ITS PROCESSES AND THE BUSINESS ENVIRONMENT

In performing an audit of cost statement, records and other related documents, the cost auditor should have the knowledge of the client's business to enable him to understand the processes and express his opinion on the cost statements. The cost auditor's level of knowledge for a cost audit engagement should include general knowledge of the economy and the industry within which the entity operates, and more particular knowledge of how the entity operates.

Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous and dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the cost auditor plans the audit and exercises professional judgment throughout the audit.

4.1 BUSINESS PROCESS

Business Processes are structured sets of activities designed to produce a specified output, they will result in transactions being recorded, processed and reported through recording of transactions either manually or information system.

Obtaining an understanding of the entity and its business process, environment, including the entity's internal control is a continuous, dynamic process of gathering, updating and analyzing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when

- Assessing risks of material misstatement of the cost statements;
- Determining materiality;
- Considering the appropriateness of the selection and application of cost accounting policies, and the adequacy of cost statement disclosures;
- Identifying areas where special audit consideration may be necessary, for example, abnormal losses, lower yields, higher wastages, higher utilities consumption, related party transactions, etc.
- Responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence; and
- Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of management's oral and written representations.

4.2 REQUIREMENTS AS PER SCA-104

No	Particulars
5.1	***The cost auditor shall have adequate level of understanding of the knowledge of Business, its Processes and the Business Environment to develop a reasonable assurance in order to express an audit opinion.***
5.2	***The cost auditor should obtain an understanding of the following:*** ***(a) The nature of the entity, (including its operations covering Business processes, major inputs, Joint & By-Products and Wastages and major outputs etc) and the entity's ownership and governance structure.*** ***(b) Relevant industry, regulatory, and other external factors including the applicable cost and financial reporting framework.*** ***(c) The entity's selection and application of cost accounting policies.*** ***(d) The measurement and review of the entity's performance.***
5.3	***The cost auditor shall obtain an understanding of internal controls relevant to the audit*** ***(a) Control Environment: The cost auditor shall evaluate whether management has created and maintained a culture of honesty and ethical behaviour.*** ***(b) The entity's risk assessment process: The cost auditor shall obtain an understanding of whether the entity has a process for:*** ***(1) Identifying business risks relevant to cost reporting objectives;*** ***(2) Assessing the likelihood of their occurrence;*** ***(3) Estimating the significance of the risks; and*** ***(4) Deciding about actions to address those risks.*** ***(c) Cost Information System/ Management Information System: The cost auditor shall obtain an understanding of the Information System including Management Information System, relevant to cost reporting including the following area;*** ***(1) The classes of transactions and their analysis, that are significant to the cost statements;*** ***(2) The procedures, by which those transactions and their analysis are initiated, recorded, processed, and reported in the management information systems and cost statements;*** ***(3) The related cost accounting records, supporting information that are used to initiate, record, process and report transactions; and*** ***(4) the reporting process used to prepare the entity's cost statements, including significant estimates and disclosures.***

	(d) Control Activities: The auditor shall obtain an understanding of the control activities, relevant to the audit *(e) Monitoring of controls:* *(1) The auditor shall obtain an understanding of the major activities, that the entity uses to monitor internal control over ;reporting.(refer 6.11)* *(2) The cost auditor shall evaluate the adequacy of the internal audit function in relation to cost records.*
5.4	*The cost auditor shall evaluate and assess:* *(1) IT Architecture, Systems and programmes in use in the entity;* *(2) Controls on access to data;* *(3) Controls on changes to data in master files, systems or programmes; an* *(4) Integrity of information and security of the data*
5.5	*The cost auditor shall identify and assess the risks of material misstatement at the cost statement level; and at the assertion level including items of cost, cost heads and disclosures thereof. For this purpose, the cost auditor shall:* *(1) Identify risks including relevant controls that relate to the risk of material misstatements or a risk of fraud;* *(2) Assess whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;* *(3) Assess whether the risk involves significant transactions with related parties;* *(4) Assess the degree of subjectivity in the measurement of information related to the risk.* *(5) Assess whether there arises a need for revising the assessment of risk based on additional audit evidence obtained.*

4.3 SOURCES OF INFORMATION ABOUT THE ENTITY

The first step in the cost audit process is to gather (or update) as much relevant information about the entity as possible. This information provides an important frame of reference for identifying and assessing possible risk factors for material misstatement due to error or fraud. Information about the entity and its environment can be obtained from both internal and external sources. In many cases, the cost auditor will start with internal sources of information. This information can then be checked for consistency with information obtained from external sources such as trade association data and data about general economic conditions, which can often be obtained from the Internet. The following exhibit shows some of the potential sources of information available.

	Internal	External
Financial	- Financial Statements - COST statements - Budgets - Performance Reports - Direct/Indirect tax Return - Financial Accounting Policies - Cost Accounting Policies - Judgements and Estimates	- Information on Internet - Industry Information - Competitive Intelligence - Credit Rating Agencies - Creditors - Government Agencies - Media or other external reports
Non-Financial	- Vision, & Mission - Objectives and Strategies - Organization Structure - Job Descriptions - HR files for Labour Data - Performance Indicators - Policy & Procedures Manuals	- Information on the Internet - Trade Associations Data - Government Agencies - Media Articles

Consider Point

A major source of information that is often overlooked is the cost auditor's working paper files from previous periods' engagements. They often contain valuable information on matters such as:

- Considerations or issues to address in planning this period's audit of cost statement;
- Evaluation and source of possible adjustments and uncorrected errors;
- Areas where there are recurring disagreements, such as the assumptions used for cost accounting estimates;
- Areas which appear to be susceptible to error; and
- Matters raised in the auditor's communication with management and those charged with governance.

4.4 UNDERSTANDING ESSENTIALS

The engagement team should obtain an understanding of the following:

(a) Relevant industry, regulatory, and other external factors, including the applicable cost reporting framework;

(b) Nature of the entity, including its operations, ownership and governance structures;

(c) The entity's selection and application of cost accounting policies including the changes thereto;

(d) Objectives and strategies, and the related business risks that may result in material misstatement of the cost statements;

(e) Measurement and review of the entity's operating performance; and

(f) Entity's Internal controls to identify types of potential misstatements, to consider factors that affect the risks of material misstatement, and to design the nature, timing, and extent of further audit procedures.

An illustrative list of factors to be considered in Understanding the Entity and its Environment, Knowledge of Business Process includes:

1. **Industry, Regulatory and Other External Factors, including the applicable Cost Reporting Framework**

✓ **Industry conditions:** Examples of matters the cost auditor may consider include:

- The market and competition including demand, capacity and price competition
- Cyclical or seasonal activity
- Changes in product technology
- Business risk (for example, high technology, high fashion, ease of entry for competition)
- Declining or expanding operations
- Adverse conditions (for example, declining demand, excess capacity, serious price competition)
- Key ratios and operating statistics
- Specific cost accounting practices and problems
- Specific or unique practices (for example, relating to labour contracts, financing methods, accounting methods)
- Energy supply sources and cost

✓ **Regulatory environment:**

- Cost Accounting principles and industry specific practices
- Regulatory framework for a regulated industry i.e. Telecom , Power, Fertilizer
- Legislation and regulation that significantly affect the entity's operations:

  - Regulatory requirement, i.e. Cost Records and Audit Rules
  - Direct supervisory activities i.e.

- Taxation (corporate and other), i.e. transfer pricing policy, captive consumption

- Government policies currently affecting the conduct of the entity's business:

  - Monetary, including foreign exchange controls,
  - Fiscal, i.e. Tax Rebate, SEZ
  - Financial incentives i.e. government aid programs, subsidies, government grants
  - Tariffs, trade restrictions, i.e. import of goods, Tax Treaty
  - Environmental requirements affecting the industry and the entity's business, i.e. Pollution Compliances, Environmental Compliances

- Other external factors currently affecting the entity's business:

- General level of economic activity i.e., recession, growth

- Interest rates and availability of financing i.e. working capital loans,borrowing cost

- Inflation, currency revaluation i.e. forex impact

2. Nature of the Entity

- Nature of business operations

- Nature of revenue sources (for example, manufacturer, wholesaler, job worker, import/export trading, captive unit, generation, distribution and transmission of power utility, transportation, technology products and services)

- Products or services and markets (for example, major customers and contracts, terms of payment, profit margins, market share, competitors, exports, pricing policies, reputation of products, warranties, order book, trends, marketing strategy and objectives, manufacturing processes)

- Conduct of operations (for example, stages and methods of production, business segments, delivery of products and services, details of declining or expanding operations)

- Alliances, joint ventures, and outsourcing activities

- Involvement in electronic commerce, including internet sales and marketing activities

- Geographic dispersion and industry segmentation

- Location of production facilities, warehouses, and offices
- Important suppliers of goods and services (for example, long-term contracts, stability of supply, terms of payment, imports, methods of delivery such as "just-in-time")
- Employment (for example, by location, supply, wage levels, union contracts, pension and other post employment benefits, stock option or incentive bonus arrangements, and government regulation related to employment matters)
- Research and development activities and expenditures
- Transactions with related parties

3. Reporting

- Cost Accounting principles and industry specific practices
- Treatment of Revenue
- Accounting Policy for fair values (if any)
- Inventories (for example, locations, quantities)
- Foreign currency assets, liabilities and transactions (for the purpose of calculation of depreciation, export incentives)
- Industry-specific significant categories (for example research and development for pharmaceuticals)
- Accounting for unusual or complex transactions including those in controversial or emerging areas (for example, accounting for production based incentives, layoff compensation)
- Cost statement presentation and disclosure

4. Objectives and Strategies and Related Business Risks

✓ Existence of objectives (i.e. how the entity addresses industry, regulatory and other external factors) relating to, for example, the following:

- Industry developments (a potential related business risk might be, for example, that the entity does not have the personnel or expertise to deal with the changes in the industry)
- New products and services (a potential related business risk might be, for example, that there is increased product liability)
- Expansion of the business (a potential related business risk might be, for example, that the demand has not been accurately estimated)

- New cost accounting or its tool or techniques requirements (a potential related business risk might be, for example, incomplete or improper implementation, or increased costs)
- Regulatory requirements (a potential related business risk might be, for example, that there is increased environmental exposure)
- Current and prospective financing requirements (a potential related business risk might be, for example, the loss of financing due to the entity's inability to produce with full capacity utilization)
- Use of IT (a potential related business risk might be, for example, that systems and processes are incompatible)

✓ Effect of implementing a strategy, particularly any effects that will lead to new cost accounting requirements (a potential related business risk might be, for example, failure of production trail)

5. Measurement and Review of the Entity's Financial Performance

Performance measures, whether external or internal, create pressures on the entity. These pressures, in turn, may motivate management to take action to improve the business performance or to misstate the cost or financial statements. Accordingly, an understanding of the entity's performance measures assists the cost auditor in considering whether pressures to achieve performance targets may result in management actions that increase the risks of material misstatement, including those due to fraud. Examples of internally-generated information used by management for measuring and reviewing performance, and which the cost auditor may consider, include:

- Key ratios and operating statistics
- Key performance indicators (illustrative list of KPI explained in latter part)
- Employee performance measures and incentive compensation policies
- Use of forecasts, budgets and trend analysis
- Segment information and divisional/ unit level performance reports
- Analyst / expert's reports
- Competitor analysis
- Period-on-period revenue growth, profitability, leverage, etc.

6. Application of Cost Accounting Policy

An understanding of the entity's selection and application of cost accounting policies may encompass matters such as:

(a) The methods the entity uses to account for significant and unusual transactions (abnormal events).

(b) The effect of significant cost accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

(c) Changes in the entity's cost accounting policies.

(d) Cost reporting framework, and laws and regulations that are new to the entity and when and how the entity has adopted such requirements.

4.5 UNDERSTANDING OF CONTROL ACTIVITIES

SCA -104 - ***"Knowledge of Business, its Process and the Business Environment"*** requires that the engagement auditor or team should obtain an understanding of the control environment. The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity.

The control environment is the foundation for effective internal control, providing discipline and structure by setting the tone at the top management influencing the control consciousness of the entity's personnel. The engagement team is required to understand how management and those charged with governance have created and maintained a culture of honesty and ethical behaviour, and established appropriate controls to prevent and detect fraud(s) within the entity. The engagement team should also consider matters such as independence of directors and their ability to evaluate the actions of management. The engagement team to also consider whether there is an audit committee which understands the entity's business transactions and evaluates whether the financial and cost statements give a true and fair view.

Note: This topic has been discussed in detail in Chapter no -7 "Evaluating Internal Control"

4.6 UNDERSTANDING THE ENTITY'S RISK ASSESSMENT PROCESS

Risks at the cost statement level may derive in particular from a deficient control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as management's lack of competence may have a more pervasive effect on the cost statements and may require an overall response by the auditor.

Risks of material misstatement at the cost statement level refer to risks that relate pervasively to the cost statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level, for example, through management override of internal control. Cost statement level risks may be especially relevant to the cost auditor's consideration of the risks of material misstatement arising from fraud.

The cost auditor's assessment of the identified risks at the assertion level provides a basis for considering the appropriate audit approach that he may follow for designing and performing further audit procedures. For example, the auditor may determine that only by performing tests of controls,he would be able to achieve an effective response to the assessed risk of material misstatement for a particular assertion.

Note: This topic has been discussed in detail in Chapter no -11 "Audit Risk Assessment & Response"

4.7 UNDERSTANDING BUSINESS PROCESS THROUGH PROCESS MAPPING

Process: *"A collection of interrelated work tasks, Initiated in response to an event."*

The objective of a process is to achieve the specific results as expected by its customer. A process can be made up of various sub-processes. Process mapping is necessary to understand the activities of the company. Following two versions of a process mapping are common:

- **As-is :** the current state of process
- **To-be**: the goal state of the process

Likely results of Process Mapping are

- Increased understanding of process;
- Increased consensus about the process; and
- Increased visibility into the process.

Step wise approach for Process Mapping is,

1. Observe process
2. Document your observations
3. Identify all the process steps & Align all the steps horizontally
4. Analyze cycle time (standard / actual)
5. List parameter that can change a product characteristics at each step (machine setting, supplies, maintenance)
6. Identify Value stream
7. Identify Value Added and Non-Value Added Activities.

Value Added (VA steps have the following characteristics)

a. Something that customer would be willing to pay.
b. Transform the product or service (shape, characteristics, usages, colour, monetary value, quality).

Non-Value Added (NVA steps have the following characteristics). NVA may be necessary to incurs due to some reason.

a. Activities that customer do not want to pay for it, but required by the company as a support activities for some reason i.e. rework, storing, handling, unloading, inspecting, set-up, downtime
b. Activities required by law or regulations
c. Activities required to reduce the financial/ liability risk
d. Activities required to support other value added requirements
e. Activities that affect process or increase process cost, if discarded
f. *Unnecessary NVA like* waste, rework, idle, shut down, break down etc.

8. List Process Inputs and Output: Each step in a process may be understood in terms of a common logic: INPUTS >>>>> TASK >>>>>> OUTPUT

   Inputs: all necessary parameters to complete a step in a Process (Human Resources, Machine, Measurement, Method, Material including Utilities and Nature)

   Task: Activities converting inputs into outputs

   Outputs: End-products; parameters that are measurable or assessable

9. Identification of Input and Output can be through brainstorming, input and output ratio, operators experience, industry standards, engineering knowledge, and other operational tools and scientific theories

10. Classification of Input-Output in following categories:

    - Uncontrollable factors in process

    - Controllable Factors- Process that can be changed to see the effect on product characteristics

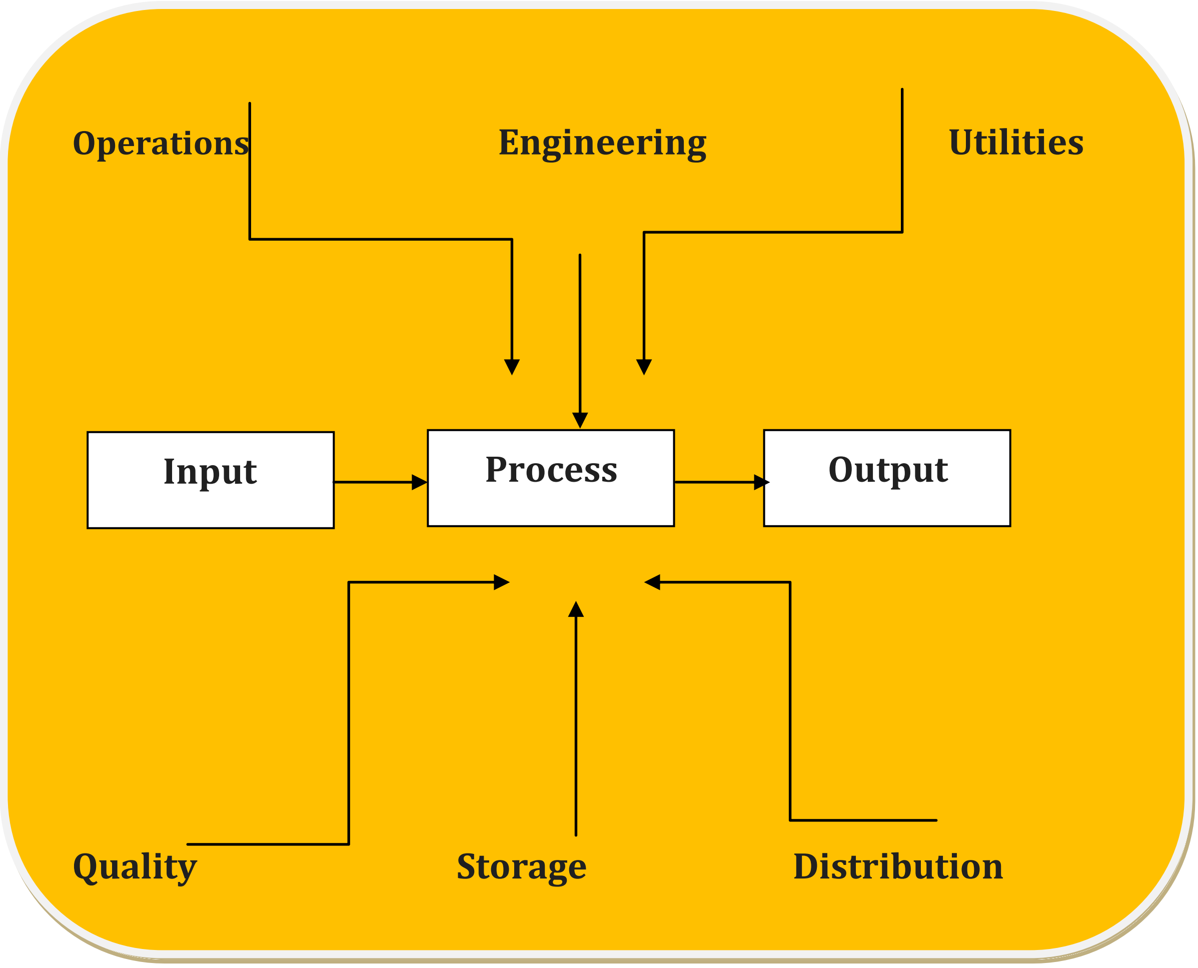
    - Standards Operating Procedures – A procedures is used to define and run those factors

    - Critical factors those determine the outcome (Product Mix, Cycle Time, Power and Fuel, Key Process, Key Operations Indicators, Unfinished/ WIP Product as Separate Product, Joint and By Product)

11. Link desired customer value to process: Time, Cost, Time Value of Money, Quality, Flexibility and Sustainability

12. Measure the Process

- Show total time as VA and NVA % for the entire process
- Analyze the NVA steps, investigate time wasted
- Calculate Cycle Time- total time elapsed to run all the steps in a process to complete a part and start the next one
- Calculate Flow Time- Total scheduled time to complete a part



For the benefit of stakeholders, we have outlined the possible benefits of Knowledge of Business and Its Process.

1. Finding where/what/when/how waste &abnormal losses are being created
2. Define elements of cycle time
3. Eliminate or combine steps
4. Improve process flow
5. Re-layout the process
6. Reduce variation, cycle times, rework, waste and manpower
7. Allocate resources better

Process Mapping may also help in focusing to eliminate waste, like:

a. Unnecessary motions, steps
b. High volume of inventory, overstock
c. Overproduction
d. Waiting, idle, queuing
e. Defects, scrap
f. Under-utilization of resources (people, equipment)

Process varies from industry to industry and process to process. The cost auditor should uses his professional judgement while acquiring the Knowledge of Business and its Process. The above elaborate articulation of Business and its Process Mapping is done with a view to enable the Cost Auditors familiarize themselves with the role of process mapping as a vital tool in the effectively and efficiently performing the audit of cost statement.

4.8 ILLUSTRATIVE LIST OF KEY PERFORMANCE INDICATOR (KPI'S)

Performance Area	KPI	Measurement
Financial Performance	***Turnover***	Segmental revenue to total revenue % Segmental turnover growth % Total turnover growth % Growth % in new product sales New product sales as % of total sales Customer-wise sales Top 5 customers, bottom 5 customers' sales
	Margin	Gross margin % on total sales Gross margin % on segmental sales Gross margin % on new products Customer-wise Gross margin %
	Cost	Element-wise cost % to total turnover Element-wise cost % to segmental turnover Cost composition – nature-wise, variability structure, functional split
	Returns	ROI on product groups ROI on geographical segments ROI on new products ROI on new markets ROCE Value added to total income Earnings per share (EPS) Dividend per share (DPS) Retention ratio Price-Earnings (PE) ratio Market price per share
	Balance Sheet	Current ratio, quick ratio Asset turnover (current and fixed assets) Growth in assets Capital expenditure % to total assets Debt-equity ratio Debt to total capital employed

Performance Area	KPI	Measurement
Productivity & Efficiency	***Material***	Material cost % to total cost Material wastage as % to total input Contribution per unit of material used
	Labour	Production per man hour Production per employee Employee cost % to sales Idle hours % to total available hours
	Machine	Production per machine hour Growth in machine capacity utilisation Machine downtime ratio Break-down hours
Manufacturing Performance	***Operating***	Material turnover
	Cycles	WIP turnover Finished goods turnover
Customer performance	***Complaints***	% of customer complaints to total orders Response time to resolve a complaint Customer-wise number of complaints Number of complaints repeated
	Development	Business growth % over 3 years
	Risks	Payment defaults Delinquencies Payment delays
	Retention and satisfaction	Customer retained over 3 years Customer satisfaction index On time order execution % Correct documentation % Customer orders delivered in full % Average time spent on customer relation
	Overall	Order-to-cash cycle days
Supplier Performance	***Delivery***	On time supplies Supply of full quantity
	Quality	% of rejections
	Cost	Price reductions agreed –cost effect Price escalations given –cost effect
	Overall	Supplier satisfaction index

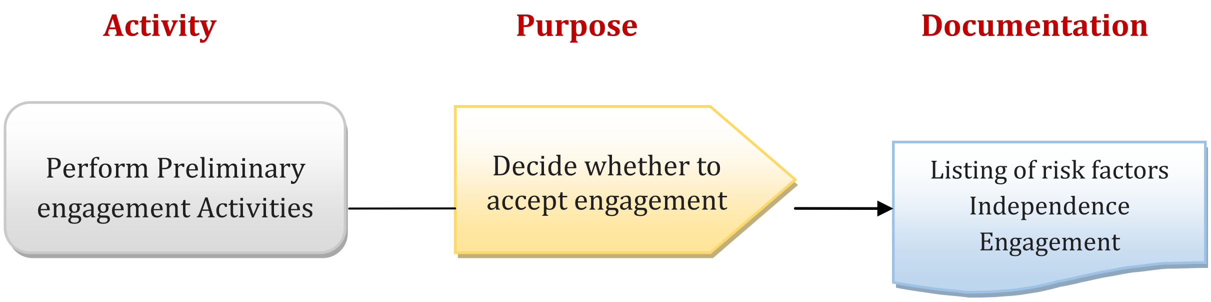
"Knowledge is experience, everything else is information"

....By Albert Einstein

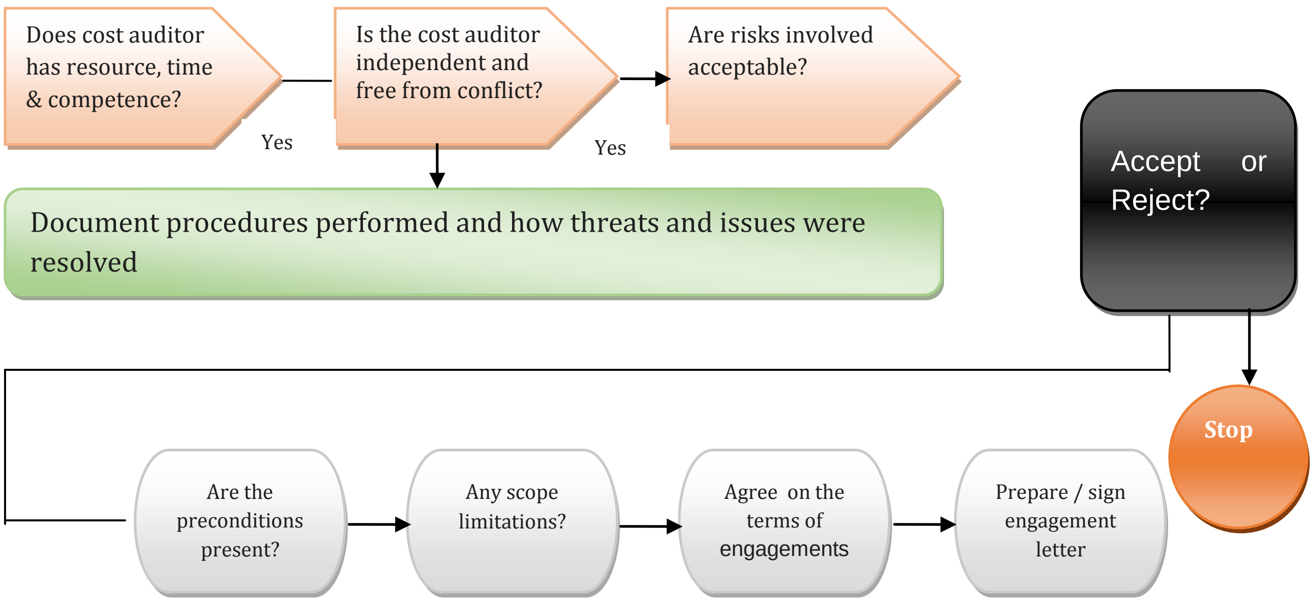
CHAPTER –5 AUDIT ENGAGEMENT

Audit Engagement refers to an engagement to perform audit by a cost auditor. It is the very first stage of an audit procedure where the client is notified by the cost auditor that the work pertaining to audit of cost statements has been accepted by him/her and also provides clarifications with regard to the scope and purpose of audit. One of the most important decisions that a cost auditor can make is determining,whether and what engagements to accept or which relationships to retain.

Major steps in the engagement acceptance / continuance process are outlined below.



Process to accept / continue with an audit engagement



To be more specific, audit engagement can be referred to the written letter that the cost auditor uses to notify the client that he/she would be engaging in auditing services. Thus, the audit engagement procedure is basically a negotiation based on professional terms that takes place between prospective client and a cost accountant entity. This procedure is often used for finding new customers and offering cost accounting & audit related services to different businesses. The cost auditor uses the term 'audit engagement' when the entity has to undergo the auditing processes of its cost statements, either specific or for general purpose. This could imply varied things and therefore it is necessary that the cost auditor clarifies what he exactly means by the engagement term.

5.1 PRE – ENGAGEMENT ACTIVITIES

With reference to requirement of Para 5.1 of SCA-101 and its interrelated application guidance under 6.3 require the cost auditor to undertake the following **activities at the beginning of the audit engagement**;

- Letter of Appointment/Engagement
- Ethical Requirements
- Establishing and understanding terms of engagement in accordance with SCA 105

Requirement of SCA-101

5.1 ***Prior to entering the planning phase, the Cost Auditor shall ensure that:***

(a) the appointment as cost auditor is proper, he has received the letter of appointment and legal formalities regarding his appointment have been complied with;

(b) the ethical requirements as per the regulations continue to be satisfied; (Refer 6.3)

(c) an understanding of the terms of reference including the units to be covered, products/services to be covered, scope of coverage where the regulations leave it to be agreed between the auditor and the auditee.

Application Guidance of SCA-101

6.3 Prior to the performance of other significant activities for the current year's audit, the auditor shall ensure that {Refer 5.1 (b)}:

(a) After the Cost Auditor has accepted the appointment for an entity, there are no changes in his position in relation to the entity that impede his arm's length relationship with the entity. Such as, acceptance of an assignment relating to designing and implementation of cost accounting system for the

5.2 LETTER OF APPOINTMENT/ENGAGEMENT

The cost auditor should agree to the terms of the cost audit engagement that shall be recorded in the engagement letter. The cost auditor should obtain formal letter of his appointment mentioning the period, nature, and scope of cost audit engagement.The preconditions of accepting / continuing any professional engagements have been set out in SCA-105. These are reproduced below:

Para 5.1 of SCA -105 "***Prior to acceptance of any engagement, the cost auditor, in order to establish whether the preconditions for an audit/professional assignment are present, shall:***

(a) Determine whether the cost reporting framework to be applied in the preparation of the cost statements is acceptable; and

(b) Obtain the agreement of management that it acknowledges and understands its responsibility:

- ***(i) for the preparation and presentation of the cost statements in accordance with the applicable cost reporting framework that gives true and fair view of cost of production or cost of operations, cost of sales, and margin for each product or service or activity, produced or provided by the entity for the period under audit;***
- ***(ii) for selection and consistent applications of appropriate cost accounting policies;***
- ***(iii) for implementation of cost accounting standards issued by the Institute, alongwith proper explanation relating to any material departures from those cost accounting standards;***
- ***(iv) for such internal control as management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error; and***
- ***(v) To provide the cost auditor with:***
  - ***(a) Access to all information of which management is aware that is relevant to the preparation/audit/review etc of the cost statements such as records, documentation and other matters;***
  - ***(b) Additional information that the cost auditor may request from management for the relevant purpose; and***
  - ***(c) Unrestricted access to persons within the entity from whom the cost auditor determines it necessary to obtain audit evidence."***

Para 5.3 of SCA-105 ***"If the preconditions for cost audit are not present, the cost auditor shall discuss the matter with management. Unless required by law or regulation to do so, the cost auditor shall not accept the proposed cost audit engagement:***

(a) If the cost auditor has determined that the cost reporting framework to be applied in the preparation of the cost statements is unacceptable; or

(b) If the agreement referred to in paragraph 5.1(b) has not been obtained.

Therefore, the first and foremost step in cost audit is the appointment of cost auditor by the entity and cost auditor should necessarily ensure that all the relevant pre-conditions for an engagement for audit of cost statements as laid down in SCA-105 are met and the appointment is as per the applicable law and regulations. In this regard, the cost auditor should ensure the following:

(a) The cost auditor (Proprietor /Firm) shall ensure that the consent letter from the cost auditor / firm is sent to the company that has finalized the appointment after the initial discussions and agreement of the terms and conditions amongst the entity and Cost Auditor.

(b) The cost auditor shall ensure that the form CRA 2 is filed depicting the correct product CETA code and also mention correctly on the form whether it is under ***regulated / non-regulated*** industry. It shall also specify number of products under reference at CETA heading.

(c) The cost auditor shall prepare the records of the meetings held with the company in connection with the appointment of the cost auditor regarding the scope of the audit with particular reference to the products/services/units to be covered under the audit of cost statement.

(d) The cost auditor shall also take care that no other assignment would be included in the scope except the cost audit as per the guidelines given by the Institute of Cost Accountants of India, the Companies Act, 2013 and Rules & Regulations made thereunder.

(e) Special care shall be taken to clearly specify that the preparation of Cost Statements is the responsibility of the entity and the cost auditor would perform the cost audit procedures, express his opinion on the position of cost statements under audit, and issue the Cost Audit Report.

(f) In the event of the entity's cost records being audited for the first time (initial audit either for the first time or there is a change of cost auditor), the following information shall be obtained:

- Memorandum and Articles of Association
- Annual Reports of the previous three years
- List of the key Management officials with their contact details
- Details of important registrations under the applicable Acts and Rules
- The process flow chart / cost flow chart
- MIS, budgets and forecast reports

If management or those charged with governance impose a limitation on the scope of the cost auditor's work in terms of a proposed audit engagement such that the auditor believes the limitation will result in the cost auditor disclaiming an opinion on the cost statements, the cost auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

If the preconditions for an audit/professional assignment are not present, the cost auditor shall discuss the matter with management. Unless required by law or regulation to do so, the cost auditor shall not accept the proposed audit engagement:

(a) If the cost auditor assesses that the cost reporting framework to be applied in the preparation of the cost, is unacceptable, or

(b) If the agreement has not been concluded.

The form and content of the cost audit engagement letter may vary for each entity. Information included in the cost audit engagement letter on the cost auditor's responsibilities may be based on the Standard on Cost Auditing SCA-103. An example of a cost audit engagement letter as set out in Appendix-Iof SCA -105 is given as Appendix-II of this document for guidance of members and other stakeholders.

5.3 ETHICAL REQUIREMENTS

The cost auditor or firm, its partner or the team leader responsible for the assignment should ensure whether members of the audit team have complied with relevant ethical requirements. It is recommended that ethical requirements may be fulfilled by the following:

(a) Methods and processes for establishing, promoting, and monitoring ethical conduct among all personnel.

(b) Policies and procedures to identify non-compliance with ethical requirements and to document both the issues identified and how they were resolved.

(c) Ethical requirements include:

(i) Independence;
(ii) Integrity;
(iii) Objectivity;
(iv) Professional competence and due care;
(v) Confidentiality;
(vi) Professional conduct; and
(vii) Technical standards

Each of the aforesaid ethical requirements has been further explained in the forthcoming paragraphs.

5.3.1 Independence

In case of cost auditors, the independence of the auditing entity is not only a requirement but an essential feature of the audit engagements. The concept of "arms length" relationship in its letter and spirit is absolutely necessary. In view of this, substantive changes have been made in the procedure for appointment of cost auditors under the Companies Act, 2013.

Notwithstanding the recent developments, since transparency, accountability and independence of the cost auditor are considered very important determinants of good enterprise governance; therefore, auditee should have the cost auditor's report as tool for better evaluation of the company's performance & risk management.

The cost auditor should assess the independence requirements which apply to the cost audit assignment. In this regard, the independence policy issues are:

(a) Policies and procedures to identify and evaluate circumstances and relationships that create threats to independence so that appropriate action may be taken to eliminate or reduce the threat to an acceptable level by applying safeguards or, if considered appropriate, by withdrawing from the engagement.

(b) Policies and procedures required to ensure compliance with the cost auditor's independence requirements of the relevant laws & rules.

(c) Requirements for engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable it to evaluate the overall impact, if any, on independence requirements of accepting or continuing with an engagement.

(d) Requirements for the engagement partner to obtain information, consider breaches if any of the firm's independence policies, take appropriate action and document conclusions on compliance with independence requirements that apply to the audit engagement.

(e) Requirements for personnel to promptly notify the firm of circumstances and relationships that creates a threat to independence so that appropriate action may be taken.

(f) Maintenance of adequate records to identify, communicate, and monitor compliance with, specific independence requirements (e.g., prohibited investment lists) so that appropriate action can be taken regarding identified threats to independence.

(g) Policies and procedures to provide the cost auditor with reasonable assurance that it is notified of breaches of independence requirements so that it may take appropriate action to resolve such situations.

(h) Processes in place to evaluate the appropriateness of undertaking non-assurance services for cost audit clients.

(i) Policies and procedures to reduce the familiarity threat including rotation of individuals with a significant role in a listed company audit engagement and limitations on employment of former partners, directors or lead auditors by audit clients or their related companies.

(j) Policies concerning fees and pricing (including fees that constitute a significant proportion of the firm's fees, overdue fees, and pricing in proposals).

(k) Disciplinary procedures regarding non-compliance with independence policies and procedures.

(l) Policies when there is actual or threatened litigation between the firm and an auditee.

(m) Policies and practices when independence is determined to be impaired including reporting to any regulatory authority where required.

(n) Policies and procedures regarding communication with the audit committee / board of directors of an auditee including provision of information to the entity allowing adequate disclosure of non-audit services in the director's report or any other document for disclosure.

5.3.2 Integrity

While carrying out the cost audit assignments, cost auditor should ascertain the integrity aspects of the entity/client. This is particularly applicable in case of new clients though such period assessment may also be carried in case of existing clients.

Integrity is associated with soundness or moral principles and character in dealings with others. For assessing and evaluating the integrity the following aspects of the client may be considered-

(a) The identity, business reputation, and attitude of the owners and key management personnel and related parties.

(b) The nature of the client's operations, including its business practices.

(c) Attitude of the management towards compliance of various statutory requirements including implementation of cost accounting standards, the internal control systems, internal audit etc.

(d) Limitations suggested / imposed on the scope of work.

(e) The reasons for the proposed appointment of the cost auditor and non re-appointment of the previous firm.

5.3.3 Objectivity

The test of objectivity shall be whether the cost audit was carried out in an impartial and fair manner without favour or prejudice. The cost auditor should base his assessment and opinion purely on facts, audit evidences and on sound analysis.

5.3.4 Professional Competence and Due Care

A cost auditor should take due care in reporting and authenticating cost statements applying his professional skills and maintaining objectivity and integrity. While exercising due care and reflecting professional competence, cost auditor should possess:

(a) an understanding of cost auditing and other Standards applicable to fulfil the auditor' responsibilities in the audit;

(b) special skills (for example, industry specific knowledge) necessary to perform the work on the cost information of the particular component; and

(c) an understanding of the applicable cost/financial reporting framework that is sufficient to fulfil the cost auditor's responsibilities.

5.3.5 Confidentiality

Confidentiality is the heart of cost and management accountancy profession and as a professional, complete confidentiality of information obtained during cost audit assignment is the basic requirement.

Relevant ethical requirements establish an obligation for the cost auditor to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or there is a legal or professional duty to do so.

5.3.6 Professional Conduct

Cost accountants are looked upon as trustworthy guardians caring for consumer protection, investor protection, guides to corporate world in cost leadership. As a corollary, their professional conduct must also be illustrative and above board.

As professionals in the field of Cost and Management Accounting, the members of the Institute of Cost Accountants of India are bound by a code of professional ethics. This code stipulates and binds cost accountants to the highest level of care, duty, and responsibility to their employers and clients, the public and their fellow professionals.

5.3.7 Technical Standards

The cost auditor should be fully conversant with various pronouncements by the cost accounting / accounting regulatory bodies and other bodies and should keep updated with the technical Standards which may be prescribed from time to time.

5.4 TERMS OF REFERENCE

The auditor shall agree to the terms of audit engagement with the management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include [*refer para 5.5 of SCA-105*]:

(a) The objective and scope of the audit of the cost/financial statements;

(b) The responsibilities of the firm;

(c) The responsibilities of management;

(d) Identification of the applicable reporting framework for the preparation of the cost/ financial statements; and

(e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

5.5 INITIAL AUDIT ENGAGEMENT

❖ Para 5.9 of SCA-101 with its interrelated application guidance require that in respect of **Initial Audit Engagement;**

  ❖ Performing procedures regarding the acceptance of the client relationship and the specific audit engagement; and

  ❖ Communicating with the predecessor auditor, where there has been a change of auditors, in compliance with relevant ethical requirements.

The cost auditor is generally more careful about accepting the new client because of lack of previous experience with the management and those charged with the governance and knowledge of the business, and associated risks affecting the cost statements. While certain assessment procedures for both the prospective and existing clients would be common, however, they may assume additional importance in case of a new client.

5.9 of SCA-101: In the initial audit, the Cost Auditor shall perform procedures regarding acceptance of the client relationship and the specific audit.

In case where the audit of the entity for the prior period was conducted by a different audit firm, the auditor shall communicate with previous auditor (Refer 6.9)

6.9 Additional Consideration in Initial Audit Engagements: The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For the initial audit, additional matters the auditor may consider in formulating the overall audit strategy and audit plan include the following.

(a) The planning activities may expand to cover consultations with the previous auditor, review of previous year's audit working papers, if not prohibited by other Law or regulation, and previous year's transactions having an impact on current year's cost.

(b) Any major issues (including the application of cost accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as cost auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.

(c) The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (such as Inventory).

(d) Other procedures required by the firm's system of quality control for initial cost audit engagements (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).

5.6 CLIENT ACCEPTANCE AND CONTINUANCE

Client acceptance and continuance encompasses both deciding on acquiring a new client or continuation of relationship with an existing one and the type and amount of staff required. The cost auditor should establish policies and procedures for the acceptance and continuance of client relationships. Typical policies and procedures involved in this process are:

1. Evaluate the client's background;
2. Determine whether the cost auditor is able to meet the ethical requirements regarding the client;
3. Communicate with the previous auditor;
4. Determine need for other cost auditor's experts;
5. Select audit team to perform the audit; and
6. Obtain an engagement letter.

5.6.1 Initial Audit/ New Client

This can happen when the auditee has come under the scope of cost audit for the first time or the audit firm is being replaced. In either case, the audit team will take enhanced time to understand the nature of the business and standards of the accounting and management practices.

Whenever it is the case of the company coming under the purview of the cost audit for the first time, the cost auditor should appraise and enlighten the client about the cost audit and also the maintenance of necessary cost records, as per the Cost Accounting Standards issued by the Institute of Cost Accountants of India. In this case, enhanced audit procedures may be required to be followed by the Cost Auditor to ensure that the cost statements comply with the applicable law & regulations.

Prior to accepting a new client, the cost auditor should obtain knowledge about the client. The cost auditor should evaluate the client's standing in the business community, financial stability and operating performance, and relations with its previous cost auditor. The main purpose is to ascertain the integrity of the client and the possibility of misstatement due to error or fraud. The cost auditor should be especially concerned with the possibility of fraudulent cost reporting framework since it is difficult to uncover.

If the client has been audited previously, the new cost auditor should contact the previous cost auditor, in order to evaluate whether to accept the cost audit engagement. The previous cost auditor should respond to the new cost auditor's request for information subject to compliance with relevant ethical requirements.

5.6.2 Continuing Clients

On recurring cost audits, the cost auditor shall assess whether circumstances require the terms of the cost audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the cost audit engagement. The cost auditor may decide not to send a new cost audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the cost audit engagement or to remind the entity of existing terms:

(i) Any indication that the entity misunderstands the objective and scope of the cost audit

(ii) Any revised or special terms of the cost audit engagement

(iii) A recent change of senior management

(iv) A significant change in ownership

(v) A significant change in nature or size of the entity’s business

(vi) A change in legal or regulatory requirements

(vii) A change in the cost reporting framework adopted in the preparation of the cost statements

(viii) A change in other reporting requirements

An illustrative prospective Client Acceptance / Existing Client's Continuation Memorandum is provided as Appendix – I

5.7 AGREEING THE TERMS OF COST AUDIT ENGAGEMENTS

SCA-105 deals with the cost auditor's responsibility in agreeing the Terms of Cost Audit Engagements relating to the audit of cost statements, records and other related documents. The specific documentation requirement of other Standards on Cost Auditing does not limit the application of this Standard on Cost Auditing. Laws or regulations may establish additional documentation requirements with respect to the engagement.

Relevant Requirements of SCA -105

Para	Relevant Extract form SCAs
5.2	***If management impose a limitation on the scope of the cost auditor's work in the terms of a proposed cost audit engagement such that the cost auditor believes the limitation will result in the cost auditor disclaiming an opinion on the cost statements, the cost auditor shall not accept such a limited engagement as cost audit engagement, unless requiredby law or regulation to do so.***
5.5	***the agreed terms of the cost audit engagement shall be recorded in cost audit engagement letter or other suitable form of written agreement and shall include:*** ***(a) The objective and scope of the audit of the cost statements;*** ***(b) The responsibilities of the cost auditor;*** ***(c) The responsibilities of management;*** ***(d) Identification of the applicable cost reporting framework for the preparation of the cost statements; and*** ***(e) Reference to the expected form and content of any reports to be issued by the cost auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.***
5.7	***If law or regulation prescribes responsibilities of management similar to those described in aforesaid para for establishing precondition for cost audit in para 5.1(b), the cost auditor may determine that the law or regulation includes responsibilities that, in the cost auditor's judgment, are equivalent in effect to those set out in that paragraph .For such responsibilities that are equivalent, the cost auditor may use the wording***

	of the law or regulation to describe them in the written agreement. For those responsibilities that are not prescribed by law or regulation such that their effect is equivalent, the written agreement shalluse the description in paragraph 5.1(b).
5.8	*On recurring audits, the cost auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.*
5.10	*If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.*
5.11	*If the terms of the audit engagement are changed, the cost auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.*
5.12	*If the cost auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:* *(a) Withdraw from the audit engagement where withdrawal is possible under applicable law or regulation; and* *(b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators*
5.13	*If the cost accounting standards issued by the Institute are supplemented by law or regulation, the cost auditor shall determine whether there are any conflicts between the cost accounting standards and the additional requirements in cost reporting framework. If such conflicts exist, the cost auditor shall discuss with management the nature of the additional requirements and shall agree whether:* *(a) The additional requirements can be met through additional disclosures in the cost statements; or* *(b) The description of the applicable cost reporting framework in the cost statements can be amended accordingly*
5.14	*If the cost auditor has determined that the cost reporting framework prescribed by law or regulation would be unacceptable but for the fact that*

	it is prescribed by law or regulation, the cost auditor shall accept the cost audit engagement only if the following conditions are present: ***(a) Management agrees to provide additional disclosures in the cost statements required to avoid the cost statements being misleading; and*** ***(b) It is recognized in the terms of the cost audit engagement that:*** ***(i) The cost auditor's report on the cost statements will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures and*** ***(ii) Unless the cost auditor is required by law or regulation to express the cost auditor's opinion on the cost statements by using phrases like "present fairly, in all material respects" or, "give a true and fair view" in accordance with the applicable cost reporting framework, the Cost Auditor's opinion on the cost statements will not include such phrases.***
5.16	***If the cost auditor concludes that additional explanation in the cost auditor's report cannot mitigate possible misunderstanding, the cost auditor shall not accept the cost audit engagement, unless required by law or regulation to do so. A cost audit conducted in accordance with such law or regulation does not comply with standards on cost auditing. Accordingly, the cost auditor shall not include any reference within the cost auditor's report to the cost audit having been conducted in accordance with standards on cost auditing.***

It is always in interest of both the entity and cost auditor that the cost auditor sends cost audit engagement letter before the commencement of the cost audit to help avoid misunderstandings with respect to the cost audit. The objective and scope of cost audit and the responsibilities of management and of the cost auditor may be sufficiently established by law or regulation. Although, SCA-105 permits the cost auditor to include in the engagement letter only reference to the fact that relevant law or regulation and that management acknowledges and understands its responsibilities, the cost auditor may nevertheless consider it appropriate to include the matters described in SCA-105 in an engagement letter for the information of management.

5.8 FORM AND CONTENT OF THE COST AUDIT ENGAGEMENT

The form and content of the cost audit engagement letter may vary for each entity. Information included in the cost audit engagement letter on the cost auditor's responsibilities may be based on Standard on Cost Auditing (SCA-105).This Standard also deal with the description of responsibilities of the management. In addition to matters included in requirement 5.5 of SCA-105 as mentioned above, a cost audit engagement letter may include, for example:

i) Elaboration of the scope of the cost audit, including reference to applicable legislation, regulations, standards on cost auditing, ethical and other pronouncements of professional bodies to which the cost auditor adheres.

ii) The form of any other mode of communication of results of the cost audit engagement.

iii) The fact that because of the inherent limitations of cost audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the cost audit is properly planned and performed in accordance with standards on cost auditing.

iv) Arrangements regarding the planning and performance of the cost audit, including the composition of the engagement team.

v) The expectation that management will provide written representations.

vi) The fact that agreement of the management to make available to the cost auditor draft cost statements and any other relevant information in time to allow the cost auditor to complete the cost audit in accordance with the proposed timetable but within the stipulated time.

vii) The agreement of management to inform the cost auditor of facts that may affect the cost statements, of which management may become aware during the period from the date of the cost auditor's report to the date the cost statements are issued.

viii) The basis on which fees are computed and any billing arrangements.

ix) A request for management to acknowledge receipt of the cost audit engagement letter and to agree to the terms of the engagement outlined therein.

and, when relevant, the following points could also be made in the cost audit engagement letter:

i) Arrangements concerning the involvement of other cost auditors and experts in some aspects of the cost audit.

ii) Arrangements concerning the involvement of internal auditors and other staff of the entity.

iii) Arrangements to be made with the previous cost auditor, if any.

iv) Any restriction of the cost auditor's liability when such possibility exists.

v) A reference to any further agreements between the cost auditor and the entity.

vi) Any obligations to provide cost audit working papers to other parties.

5.9 RECURRING COST AUDITS

Further, the cost auditor may decide not to send a new cost audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the cost audit engagement or to remind the entity of existing terms:

i) Any indication that the entity misunderstands the objective and scope of the cost audit
ii) Any revised or special terms of the cost audit engagement
iii) A recent change of senior management
iv) A significant change in ownership
v) A significant change in nature or size of the entity's business
vi) A change in legal or regulatory requirements
vii) A change in the cost reporting framework adopted in the preparation of the cost statements
viii) A change in other reporting requirements

5.10 ACCEPTANCE OF A CHANGE IN TERMS OF THE COST AUDIT ENGAGEMENT

A request from the entity for the cost auditor to change the terms of the cost audit engagement may result from a change in circumstances affecting the need for the service, a difference of opinion or misunderstanding as to the nature of cost audit as originally perceived or a restriction on the scope of the cost audit engagement, whether imposed by management or caused by other circumstances. The cost auditor may consider the justification given for the request, particularly the implications of a restriction on the scope of the cost audit engagement.

If management requests changes to the terms of the audit engagement, the auditor would consider whether there is reasonable justification for the request, and the implications for the scope of the audit engagement. A reasonable justification could include a change in the client's circumstances or a misunderstanding of the nature of the original service requested.

In contrast, a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete, or otherwise unsatisfactory. An example might be where the cost auditor is unable to obtain sufficient appropriate cost audit evidence and the entity asks for the cost audit engagement to be changed to avoid a qualified opinion or a disclaimer of opinion.

If the change in terms is reasonable, a revised engagement letter or other suitable form of written agreement would be obtained. If, however, the auditor is unable to agree to the proposed change in terms and is not permitted by management to continue the original audit engagement, the auditor is required to:

- Withdraw from the audit engagement where possible under applicable law or regulation; and
- Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners, or regulators.

5.11 ADDITIONAL CONSIDERATIONS IN ENGAGEMENT ACCEPTANCE

If the Cost Accounting Standards are supplemented by any law or regulation, then the cost auditor should ensure that the additional information, if any required by such law or regulation, should not be in conflict with the Cost Accounting Standards. In case of a conflict, he in consultation with the management should either make suitable disclosures or amend the cost reporting framework to encompasses both the identified cost reporting framework and such additional requirements.

The cost auditor shall use phrases such as “present fairly, in all material respects” or “give a true and fair view” only if the law or regulation prescribes the use of same in the format of the of the cost audit report prescribed under any law or regulation.

Standards on Cost Auditing require that the cost auditor shall not represent compliance with Standards on Cost Auditing unless the cost auditor has complied with all of the Standards on Cost Auditing relevant to the cost audit. When law or regulation prescribes the layout or wording of the cost auditor’s report in a form or in terms that are significantly different from the requirements of Standards on Cost Auditing and the cost auditor concludes that additional explanation in the cost auditor’s report cannot mitigate possible misunderstanding, the cost auditor should not make any reference in his report as to complying with the Standards on Cost Auditing in the conduct of such audit. The cost auditor may, however, apply these Standards on Cost Auditing in conduct of such audit.

5.12 PRACTICAL ASPECT

The first step in the client acceptance or continuance process is to assess the cost auditors' or firm’s ability to perform the cost audit engagement, and the risk involved. The following exhibitsoutlines some possible lines of inquiry.

Consideration	Line of Inquiry
Entity’s Quality Control Requirements	What policies and procedures are in place to provide reasonable assurance that a cost auditor will only

	undertake or continue relationships where: • The cost auditor can comply with the SCA requirements; and • The engagement risks involved are within the Cost Auditor's tolerance for risk.
What Work is Required?	• What is the nature and scope of the cost audit? • What cost accounting framework will be used? • How will the cost auditor' report and cost statements be used? • What is the deadline (if any) for competing the audit of cost statements?
Does the cost auditor or firm has competence, resource, and	Does the firm have sufficient personnel with the necessary competence and capabilities? • Do the selected firm personnel have: - Knowledge of relevant industries or subject matters, - Experience with relevant regulatory or reporting requirements, or - Ability to gain the necessary skills and knowledge effectively. • Are experts available, if needed? • Where applicable, are there qualified persons available to perform the engagement quality control review? • Can the cost auditor or firm complete the engagement within the reporting deadline?
Is the cost auditor Independent?	Can the cost auditor and the engagement team comply with ethical and independence requirements? Where conflicts of interest, lack of independence, or other threats have been identified: - Has appropriate action been taken to eliminate those threats or reduce them to an acceptable level by applying safeguards, or - Have steps been taken to withdraw from the engagement?
Are the risks involved	• For new engagements, has the cost auditor communicated with the predecessor cost auditor to

Acceptable?	determine if there are any reasons for not accepting the engagement? • How competent are the entity's senior management and staff? • Are there difficult or time-consuming issues to address (cost accounting policies, estimates, compliances etc.)? • What changes have taken place this period that will impact the engagement (business trends and initiatives, personnel changes, reporting framework, IT systems, purchase/sale of assets, regulations, etc.)?
Can the Client be Trusted?	• Are there any scope limitations, such as unrealistic deadlines or an inability to obtain the required audit evidence? • Is there any reason (or recent event) that casts doubt on the integrity of the principal owners, senior management, and those charged with governance of the entity? Consider the entity's operations, including business practices, the business' reputation, and history of any ethical or regulatory infringements. • What is the identity and business reputation of related parties? • Does management have a poor attitude toward internal control and an aggressive attitude toward interpretation of cost accounting standards? Consider corporate culture, organizational structure, risk tolerance, complexity of transactions, etc.

Once a decision has been reached to accept or continue with the client engagement, the next step is to:

- Establish whether preconditions for an audit of cost statements are present; and
- Confirm a common understanding between the cost auditor and management (where appropriate, with those charged with governance) of the term of the audit of engagement.

Consideration	Line of Inquiry
Are the preconditions of audit of cost statements present?	Factors to consider include: • The nature of the entity (business, public sector, or not-for-profit); • The purpose of the cost statements (common purpose or for specific users); • The nature of the cost statements (Standalone or company as a whole); and • Whether law or regulation prescribes the applicable cost reporting framework. Does management agree to and acknowledge/understand its responsibility for: • Preparing the cost statements in accordance with the applicable cost reporting framework, including (where relevant) their fair presentation; • Such internal control as management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error; and • Providing the cost auditor with: - Access to all relevant information such as records, documentation, and other matters, - Additional information requested from management for the purpose of the audit of cost statements (such as written representations), and - Unrestricted access to persons within the entity to obtain the necessary audit evidence?
Is there a Scope Limitation?	Has management or those charged with governance imposed any type of limitation on the scope of the audit of cost statements? This could include unrealistic deadlines, not accepting certain staff to perform the work, and denial of access to a facility, key personnel, or relevant documents. If such a limitation would result in a disclaimer of opinion, the cost auditors would decline the engagement, unless the firm is required by law or regulation to proceed with the engagement.

The engagement letter (Appendix -II) would address the matters set out below

Consideration	Line of Inquiry
The Objective, Cost Accounting Framework, Scope, and Form of Cost Auditor's Report Resulting from the Auditof the Cost Statements	The cost accounting framework to be used. • Objective of the audit of cost statements and the anticipated form of cost auditor's report or other communication. Also, the circumstances in which a report may differ from its expected form and content. • The scope of the cost audit, including reference to applicable legislation, regulations, SCAs, and ethical and other pronouncements of professional bodies to which the cost auditor adheres. • Other parties to whom a report is required to be made (e.g., a regulator).
The Responsibilities of the Cost Auditor	• To conduct the audit in accordance with Standards on Cost Auditing(SCAs). • Recognition that, due to the inherent limitations of an audit of cost statements and the limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit of cost statement is properly planned and performed in accordance with SCAs.
The Responsibilities of Management	• For the preparation of the cost statements in accordance with the applicable cost framework, and for designing and implementing such internal control as management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error. • Accept the terms of the engagement as outlined in the engagement letter. • Provide unrestricted access to any records, documentation, and other information requested in connection with the audit. • Provide unrestricted access to persons within the entity • Confirm cost auditor's expectation of receiving written confirmation from management concerning representations made in connection with the audit of

	cost statement. • Agreement of management to inform the cost auditor of facts that may affect the cost statements, of which management may become aware during the period from the date of the cost auditor's report to the date the cost statements are issued.
How the Audit Will be Conducted, Any DisputeResolution, Obligations, and Fee Arrangements	Address arrangements regarding: • The planning and performance of the audit, including the composition of the audit team and details of what (if any) draft cost statements or other working papers are to be prepared by the client, along with the dates on which the cost auditor requires these; • Involvement of other auditors and experts; • Involvement of the predecessor cost auditor; and • Other matters: - Any restrictions of the cost auditor's liability where such possibility exists, - The basis on which fees are computed and any billing arrangements, - Any obligations by the firm to provide audit working papers to other parties, and - Reference to any further agreements between the cost auditor and the client, or other letters or reports the auditor expects to issue to the client. Client to confirm the terms of the engagement by acknowledging receipt of the engagement letter.

"The best you can expect, if you do not communicate average and high performance norms, is to sustain mediocrity"

.... By Bob Kelleher

CHAPTER –6 AUDIT PLANNING

The audit [process] planning is a fundamental basis in the exercise of audit process. The cost auditor should develop plans and strategies to avoid potential issues. The plan includes an upgraded help in identifying problems well in advance, regardless of their size and complexity. The audit strategy would involve setting such audit procedures so as to solve these problems and ensure a neutral and clean opinion about the fairness and credibility of the company's cost statements, when audited.

Audit planning is necessary for number of reasons of which the foremost is to achieve audit efficiency and effectiveness. Audit plan involves planning risk assessment procedures, and other audit procedures to obtain sufficient & appropriate audit evidence. During the course of audit, if the cost auditor concludes that the initial plan requires alteration, then cost auditor shall consider revising audit strategy as well, if needed. Change in audit plan involves change in the scope, timing or extent of planned audit procedures. Cost auditor shall document the audit plan and any changes thereto.

It is reasonable to assume that planning occurs towards the start of an audit engagement. However, according to SCA 101, planning should not be seen as a discrete and separate part of the overall audit. Planning often begins shortly after, or in connection with the completion of the previous audit. For example, it involves review of issues that were discussed with the management, such as control deficiencies or unadjusted errors or abnormal losses. Such matters are relevant to the next year’s cost audit and need to be considered when planning.

Similarly, the audit plan may be revised as the audit progresses, and should not be viewed as being fixed in place once the main planning phase has ended. For example, a significant change in process / production activities may take place as the audit of cost statements is in progress, meaning that the audit plan needs to be changed. The nature and extent of planning activities depends on the size and complexity of the audit client, previous experience of the audit firm with the entity, and any changes in circumstance that may occur during the audit of cost statements.

6.1 NEED OF AUDIT PLANNING

Adequate planning helps the cost auditor in auditing cost statements in number of ways and includes:

- Giving suitable attention to important areas of audit;
- Identifying and resolving problems in timely manner;
- Organizing and managing cost audit to conduct it efficiently and effectively;
- Helping cost auditor in selecting audit team members and assigning work to them and also helps in coordinating work of other auditor and experts; and

- Facilitating cost auditor to direct, supervise and review the work of team members.

6.2 ROLE AND TIMING OF PLANNING

The nature of audit planning depends on:

- Size and complexity of an entity;
- Cost auditor's previous experience of the same entity; and
- Changes in circumstances during audit engagement

It is not a standalone stage of an audit which takes place at the start of every audit. Moderately planning can be done or revisited as and when it is needed even during the audit engagement i.e. it is an iterative and continual process.

6.3 PLANNING IS NOT A DISCRETE PHASE OF AN AUDIT, BUT RATHER A CONTINUOUS AND ITERATIVE PROCESS.

Planning often begins shortly after (or in connection with) the completion of previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that needs to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

- ❖ Analytical procedures;
- ❖ Obtaining an understanding of the applicable legal and regulatory framework and how the entity is complying with applicable framework i.e. Power Generation Sector, Telecom Sector;
- ❖ The determination of level of materiality;
- ❖ The involvement of experts, if required; and
- ❖ The performance of assessment procedures as applied in previous audit of cost statement, if any.

The cost auditor may discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the cost auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

Planning also includes scheduling which involves determining the priority of audit procedures and their inter dependence. For example, the risk assessment procedures are planned early in the audit process.

6.4 SCA-101 PLANNING AN AUDIT OF COST STATEMENTS - AN OVERVIEW

Planning an audit of cost statements, records and other related documents isconsidered necessary to ensure achievement of audit objectives with available resources and securing coordination with auditee on audit work.

The objective of auditor is to plan the audit of cost statements to ensure it is performed in an efficient and effective manner, while objective of SCA-101 is to guide members in such planning for the audit of cost statements so that it is performed in an effective and efficient manner.

SCA-103 defines the overall objectives of the cost auditor by using all the relevant Standards as,

> *"to obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud and error, and to enable the auditor to express an opinion whether the cost statements are prepared, in all material respects, in accordance with the applicable Cost reporting framework, Cost Accounting Standards (SCA's) and Generally Accepted Cost Accounting Principles (GACAP) as issued by Institute, and give a true and fair view of the cost of a product, activity or service. In the case of a Cost Audit under the Companies Act and Rules prescribed thereunder, the objectives is to express an opinion on whether the cost statements subject to audit represent a true and fair view of the cost of production, cost of sales and margin of products covered by Cost Audit".*

In order to achieve the aforesaid objectives, the cost auditor is expected to develop a strategy for addressing potential audit risks and plan the intended course of nature, timing and extent of procedures required to discharge the responsibilities.To formulate appropriate audit procedures and audit plan in accordance with overall audit strategy is fundamental to the success of an audit of cost statements to be conducted to achieve overall objective of cost auditor. Developing the appropriate audit strategy facilities achievement of overall audit objective at border level while planning involves enlisting of task to methodically achieve desired results in productive and concrete manner.

6.4.1 SCA 101 - Requirements

❖ SCA 101 requires to get **engagement partner and other key members of the engagement team** to get involve in

- ❖ Planning; and
- ❖ Discussion

- SCA 101 requires to undertake the following **activities at the beginning of the audit engagement**:
    - Ethical Requirements
    - Establishing and understanding terms of engagement in accordance with SCA 105
- SCA 101 requires to establish **overall audit strategy** that includes:
    - Understanding of business processes, knowledge from previous audits, nature and scope of audit;
    - Ascertain the statutory deadlines and reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
    - Consider the factors that are significant in directing the engagement team's efforts;
    - Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
    - Ascertain the nature, timing, and extent of resources necessary to perform the engagement.
- SCA 101 requires to develop **audit plan** that involve:
    - The nature, timing and extent of planned risk assessment procedures, as determined under SCA 117;
    - The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SCA 118; and
    - Other planned audit procedures that are required to be carried out so that the engagement complies with all other related SCAs.
- SCA 101 requires to plan the nature, timing and extent of **direction and supervision**.
- SCA 101 requiresto**document** the overall audit strategy, audit plan and any significant changes.
- SCA 101 requiresthe followingin respect of **Initial Audit Engagement:**
    - Performing procedures regarding the acceptance of the client relationship and the specific audit engagement; and
    - Communicating with the predecessor auditor, where there has been a change of auditors, in compliance with relevant ethical requirements.

Planning an audit is one of the most integral part of the audit, Without an adequate programme of planning by the cost auditor, there is wide scope for a material misstatement (or multiple material misstatements) to be missed, resulting in the expression of an incorrect audit opinion by the cost auditor as well as other repercussions. Planning takes place before the start of an audit engagement and must never be seen as a stand-alone part of the cost audit and may need revision as the cost audit progress.

Planning activities for a new audit engagement will often be more in depth than for a recurring engagement because the cost auditor will not have previous experience of the audit engagement with the said entity, and, therefore, the cost auditor will need to develop an understanding of the entity and the environment in which it operates to comply with the provisions of SCAs

Planning includes identifying audit risk while obtaining the understanding of the business, assessing the identified risk and responding to audit risks by designing the adequate audit procedures and applying them to obtain sufficient appropriate audit evidence to bring down the audit risk to an acceptable level. Planning also includes consideration of materiality and application of analytical procedures.

Planning consists of:

(a) Developing an overall audit strategy
(b) Overall Audit Plan to lead to the preparation of detailed audit programme

To develop the above documents the auditor needs to perform certain initial activities;

(i) Initial meeting with the client
(ii) Risk assessment procedures

6.5 DISCUSSION

An engagement team discussion is often held at the start of the planning work where the team will look at the completion side of the previous audit, review unadjusted errors, discuss any control deficiencies that they noted during the previous year's detailed audit work and a summary of matters that were discussed with management and, where applicable, those charged with governance, during the previous audit. A critical element in the success of any audit engagement is good communication among the audit team members.

SCA-109, enlist the following matters that may include for discussion among audit team:

- An exchange of ideas among audit team members about how and where they believe the entity's cost statements may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent cost reporting, and how assets of the entity could be misappropriated.

- A consideration on analysing the budgets, forecasts, variance analysis, key ratios etc.
- A consideration of circumstances that might be indicative of revenue management and the practices that might be followed by management to manage revenues that could lead to fraudulent cost reporting.
- A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.
- An emphasis on the importance of maintaining a proper state of mind throughout the cost audit regarding the potential for material misstatement due to fraud.
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the cost audit procedures to be performed.
- A consideration of the cost audit procedures that might be selected to respond to the susceptibility of the entity's cost statement to material misstatement due to fraud and whether certain types of cost audit procedures are more effective than others.
- A consideration of any allegations of fraud that have come to the cost auditor's attention.
- A consideration of the risk of management override of controls.

SCA-117 states the following matters for discussion among the audit team about the susceptibility of the entity's cost statements to material misstatement:

- Provides an opportunity for more experienced audit team members, including the audit partner, to share their insights based on their knowledge of the entity.
- Allows the audit team members to exchange information about the business risks to which the entity is subject and about how and where the cost statements might be susceptible to material misstatement due to fraud or error.
- Assists the audit team members to gain a better understanding of the potential for material misstatement of the cost statements in the specific areas assigned to them, and to understand how the results of the audit procedures that they perform may affect other aspects of the audit including the decisions about the nature, timing and extent of further audit procedures.
- Provides a basis upon which audit team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks.

- It is not always necessary or practical for the discussion to include all members in a single discussion (as, for example, in a multi-location audit), nor is it necessary for all of the members of the audit team to be informed of all of the decisions reached in the discussion.
- The audit partner may discuss matters with key members of the audit team including, if considered appropriate, those with specific skills or knowledge, and those responsible for the audits of components, while delegating discussion with others, taking account of the extent of communication considered necessary throughout the audit team. A communications plan, agreed by the audit partner, may be useful.

The following exhibit summarizes what to consider and discuss among the audit team communications.

Assigning team members and roles

Consider:

- Skills and experience
- Need for experts
- Need for engagement quality control reviewer

Audit planning meeting

Discuss:

- Materiality
- Insight based on knowledge of entity.
- Potential business and fraud risks
- How/ where cost statements might be susceptible to material misstatement
- Audit plan including who, what, where & when
- Supervision and review

During and after the cost audit

Discuss:

- Audit results, progress, and issues identified
- Changes in audit plan
- New information available
- Unusual events/ Transactions during the audit of cost statements
- Suggestions for next period's audit of cost statements

The overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team. In order to take the right decisions, the auditor shall perform certain preliminary engagement activities at the commencement of the current audit engagement to identify and evaluate events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement. Further, certain additional considerations are required for an initial engagement as compared to a continuing engagement.

6.6 OVERALL AUDIT STRATEGY

"Overall Audit Strategy: Overall Audit Strategy sets the scope, timing and direction of the audit and guides the developments of the detailed audit plan."

The audit strategy sets out in general terms how the audit is to be conducted and sets the scope, timing and direction of the audit. The audit strategy then guides the development of the audit plan, which contains the detailed responses to the auditor's risk assessment. An underpinning principle of audit planning is that the audit plan should contain detailed responses to the specific risks identified from obtaining an understanding of the audited entity.

Developing an audit strategy involves:

1) **Identification of characteristics of cost audit engagement:** Some audit engagements have specific characteristics that wider the scope than audit of a small entity having single product. For example, a lead auditor engagement or the audit of multi location facilities of a company engaged in production of multiple products or rendering multi-faceted services will have wider scope than an audit of a small entity with one unit & one product. Other matters such as the IT environment, complexity of operations, specific regulatory requirements, need of experts, etc. are also relevant.

2) **Determining the reporting objectives of the engagement:** Reporting requirements may vary from audit to audit. For example, some entities have additional reporting requirements to comply with law and regulations by regulator or industry requirements, and the cost auditor must understand these requirements from the start of the cost audit.

3) **Planning the timing and nature of audit communications:** The nature of communications that may be necessary during the audit should be considered, such as liaison with other auditors, cost auditor' expert, communications with management and with those charged with governance.

4) **Determining the factors to which the audit team should direct their efforts:** The audit strategy must consider issues to do with quality of audit and control, such as how resources are managed, directed and supervised. When team briefing and debriefing meetings are to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site).

5) **Determining the factors that, in the cost auditor's professional judgement, are classed as 'significant':** The significant matters are:

   - Nature of the Industry – priority industry, export oriented industry etc.
   - Production Method / Process

- Important raw material and their sources - BOM, Power, Gas, Fuel
- Licensed capacity and installed capacity
- Method of costing in use
- Cost reporting framework / Cost accounting policies adopted
- Method of accounting of raw materials, stores and finished goods
- Method of accounting of wastages, spoilage and rejections
- Method of allocation , assignment and absorption of cost
- Records relating to jigs, moulds and dies
- System of wages, salaries and other employee's benefits
- Basis of allocation of overheads
- Method of allocation of service department expenses
- Method of accounting of depreciation, revaluation loss or impairment of assets
- Agreement with collaborators or other for payments of royalty, its computation and payment
- Accounting for sales and purchases – treatment of indirect taxes
- Method of accounting of credit, recoveries, subsidies or grant
- System of year-end stock taking
- Method determination of work in progress
- Inventory valuation policy and method of calculation of net realisation value
- Systems of budgetary control
- Contemporary Management tools and techniques i.e. kaizen, lean accounting, Just-in-time inventory, target costing, transfer pricing policy
- System of internal control, internal audit reports
- State of internal control over cost accounts and cost accounting records
- Cost accounting manual, if any
- Special cost accounting practices and methods peculiar to the industry under audit
- Treatment of Revenue
- Captive consumption of goods or services
- Generation of Power or other gas or fuel and its accounting
- Variance analysis

6) **Considering the results of preliminary audit engagement activities:** This includes the initial assessments of materiality, risks identified from preliminary activities such as fraud risks, significant events that have occurred at the entity or in the industry in which it operates since the last audit, and the results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them. The audit firm may also have performed other services for the client that may be relevant in determining the audit strategy, for example, benchmarking, capacity determination, or price forecasting.

6.6.1 Determining the Nature, Timing, and Extent of Resources Needed to Perform the Cost Audit Engagement:

One of the main objectives of developing the audit strategy is to effectively allocate resources to the audit team, for example, the use of specialists on particular areas of the audit, or building a team of highly experienced auditors for a potentially high-risk audit engagement. If the audit is time pressured due to tight deadline, then more resources will need to be allocated to ensure that all necessary audit work is completed, and can be reviewed in time to meet the deadline.

For formulating the audit strategy, the cost auditor should take the following practical aspects:

1. Self-appraisal of the knowledge of operations - this phase may require more interaction with the officials of the company at various levels. More relevance requires on adequate and functional knowledge of the operational areas that includes:

    - Number of products / units and locations
    - Joint products/ by-products/scrap/wastages
    - Input to Output norms / ratios
    - Trend Analysis - Consumption, Wastages, Production and Contribution, Power and Fuel, Man Hours, Machine Hours, Overhead Rates.
    - Power consumption and cost per unit of power consumed
    - Material storage
    - Process flows – Routing and Cost Flow and Benchmarking
    - Technology up-gradation, obsolescence or changes (if any)
    - Working capital
    - Capacity utilization
    - Industry regulators' requirement as to how costs will be handled
    - Unique features of an industry that influence audit requirements.
    - Other important aspects specific to the industry

2. Extent of reliance that can be placed on the work of other auditors, branch or unit cost auditors appointed by the entity and internal auditors.

3. Consultation with the previous cost auditor to understand and take a view of the impact of previous year that may creep into the current year's audit.

4. Statutory time lines for cost reporting, management responsibilities and expectations.

5. Timelines for Board/ Audit Committee meetings which can set the priority for completion of audit work.

6. Any special / additional resources required to execute and complete the audit.
7. Operational issues noticed during the risk assessment phase.
8. Extent and level of cooperation / support provided by the officials of the auditee.

(i) If the company is implementing a new ERP system, the officials would not have been trained yet; this may cause passive response from them. The audit team may have to help them in solving the issues in the preparation of the report format templates and other associated constraints.

(ii) In some cases, switching over from manual or other accounting packages to ERP would be just happening. This would also have an impact on your audit strategy.

(iii) In the initial audit where the auditee is first time under the cost audit purview, the preparation of cost statements would be little critical as systems and controls yet to get stabilized. It needs initial counselling from the cost auditor.

The amendments to the overall audit strategy and plan (with consequential effect on nature, timing and extent of further audit procedures) may be required on account of:-

- Unanticipated events
- Changed conditions
- Inconsistent information
- Divergence noted between the expected audit evidence and the actual evidence

6.6.2 Considerations in Up-Gradation or Revision of the Overall Audit Strategy

The following considerations provide examples of matters the cost auditor may consider in establishing the overall audit strategy as well as up-gradation and revision thereof as the audit progresses. Many of these matters may also influence the auditor's detailed audit plan. The examples provided cover broad range of matters applicable to many engagements; the list is not necessarily complete.

6.7 CHARACTERISTICS OF ENGAGEMENT

- The cost reporting framework showing the cost information to be audited, including any need for reconciliation with another reporting framework. For example, reconciliation with financial statements or reconciliation of statement of indirect taxes with other indirect tax returns /audit reports.

- Industry specific reporting requirements as may be mandated by industry regulators i.e. Power Industry, Telecom Industry.

- The expected audit coverage, including the number and locations of units / plants to be included i.e. multi locations or multi product or both.

- Nature of relationship among various production/service units that determines how the cost statements as a whole are to be prepared i.e. captive consumption, inter-unit transfer pricing.
- The extent to which units are audited by other cost auditor(s).
- The nature of operations / business segments to be audited, including the need for specialized knowledge i.e. mining or shipping.
- Whether the entity has internal audit functions and if so, whether, in which areas and to what extent, the work of function can be used or internal auditors can be used to provide direct assistance for the purpose of cost audit i.e. process / performance audit report by internal auditor.
- The entity's use of service organization and how the cost auditor may obtain evidence concerning the design or operations performed by them i.e. technical know-how or software support.
- The expected use of audit evidence obtained in previous audit, i.e. audit evidence related to risk assessment procedures and test of controls.
- The effect of information technology on the cost audit procedures, including the availability of data and the expected use i.e. computer assisted audit techniques.
- The coordination of the expected coverage and timing of audit work with any review on interim cost statements and the effect of audit of the information obtained during such review i.e. significant change in key ratios.

6.8 REPORTING OBJECTIVES, TIMING OF COST AUDIT, AND NATURE OF COMMUNICATIONS

- The entity's schedule for cost reporting framework i.e. Interim or Final Cost reporting framework.
- Organization of meetings with management to discuss the nature, timing and extent of audit work i.e. pre-engagement meetings, interim meetings to obtain understanding or discussion on cost audit finding's and final meeting before forming an audit opinion.
- Discussion with management regarding the expected timing of reports to be issued and other communications, both written and oral i.e. Cost Audit Report to Board of Directors / Audit Committee.
- Communication with cost auditors of units regarding timing of reports to be issued and other communications.

- Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of audit work done, i.e. review of audit procedures performed.

- Any other expected communications with third parties, i.e. job worker, third party stock confirmation, loss in transit confirmation etc.

6.9 SIGNIFICANT FACTORS, PRELIMINARY ENGAGEMENTS ACTIVITIES AND KNOWLEDGE GAINED ON OTHER ENGAGEMENTS

- The determination of materiality in accordance with SCA-108 and, where applicable:
    - determination of materiality for units and communication thereof to branch cost auditor.
    - preliminary identification of significant components and material classes of transactions, cost heads, items of cost and disclosures.

- Preliminary identification of area where there may be a higher risk of material misstatements i.e. BOM cost, inventory valuation, overheads-basis of apportionment, recognition of revenue, etc.

- Likely impact of assessed risk of material misstatement at the overall cost statement level.

- Manner in which the cost auditor emphasizes to his engagement team members regarding the need to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence i.e. skepticism regarding key ratios, overhead rates, etc.

- Results of previous audit that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and the action taken to address them i.e. incorrect classification of items of cost or lack of operating controls.

- Evidence of management's commitment to design, implement, and maintain sound internal control systems, including evidence of appropriate documentation of such internal controls. For example, lack of control for effective usage of delegated authority.

- Effectiveness of internal control systems commensurate with the scale of operations - whether the cost auditor can rely on.

- Significant business developments affecting the entity, including changes in information technology and business processes, changes in key management, i.e. diversification of business or new product or portfolio introduced to business.

- Significant industry developments such as changes in industry regulations and new reporting requirements.
- Significant changes in the cost accounting policy / accounting policy that may affect the cost reporting framework i.e. adoption of fair value estimates
- Other significant recent developments, such as changes in legal environment affecting the performance of entity i.e. changes in environmental law / policy.

The cost auditor should document the following aspects while planning the audit of cost statements:

- The Overall Audit Strategy
- The Audit Plan
- Significant changes made during the audit
- Reasons for such changes

The cost auditor may summarize the overall audit strategy in the form of audit strategy memorandum and memo that contain key audit finding and decisions made regarding the overall scope, timing and conduct of the audit of cost statements. The cost auditor should share the audit strategy memorandum with the audit team members and share the overall strategy memo with management or those charged with governance.

An illustrative format of audit strategy memorandum and overall strategy memo has been included in Appendix – III to this practical guide.

6.10AUDIT PLAN

The audit plan is more detailed than the overall audit strategy as it includes the nature, timing and extent of audit procedures to be performed by audit team. Once the overall audit strategy has been established, an audit plan can be developed to address the various issue identified in formulating overall audit strategy, taking into account to achieve the cost audit objectives through the efficient use of the cost auditor's resources and timely completion.

Let us understand the Audit Plan (Refer Para 4.3 of SCA-101)

Audit Plan: A record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks.

An Audit plan is the specific guideline to be followed when conducting an audit. It helps the auditor obtain sufficient appropriate evidence for the circumstances, helps keep audit costs at a reasonable level, and helps avoid misunderstandings with the client.

It addresses the specifics of what, where, who, when and how:

1. What are the objectives of audit of cost statements?
2. What audit procedures is to carried out?
3. Where will the audit be done? (i.e. scope)
4. When will the audit(s) occur? (How long, interim / final)
5. Who are the cost auditors?
6. How will audit of cost statements is to be done?

For the audit plan, standard audit programs and/or checklists drawn up on the assumption of few relevant control activities may be used provided that they are tailored to the circumstances of the engagement, including the auditor's risk assessments. While considering the requirements of SCA -101 for developing an audit plan that involve;

- ❖ The nature, timing and extent of planned risk assessment procedures;
- ❖ The nature, timing and extent of planned further audit procedures at the assertion level; and
- ❖ Other planned audit procedures that are required to be carried out so that the engagement complies with all other related SCAs.

The three attributes nature, timing, and extent of planned audit procedures are explained below.

6.10.1 Nature

The nature of the audit procedures is fundamental to responding to audit risks and covers its type *(inspection, observation, inquiry, confirmation, recalculation, re-performance, etc.,)* and its purpose (*tests of controls or substantive procedures)*

The nature of procedures may depend on:

- ➢ **Assertions tested** – for example, in relation to audit of selling & distribution cost, tests of controls / substantive analytical procedures may be suitable to validate completeness assertion; tests of details may be necessary to validate accuracy/ ownership whereas observation may be appropriate for existence.
- ➢ **Level of risk** – Combination of audit procedures may be required to address certain elevated risks, for example, in relation to audit of consumption data, inspection of records for free supply materials received may be supplemented by external confirmation process.
- ➢ **Characteristics of items of cost** – If the assessed risks are higher based on the expectation of inherent internal control, tests of controls is a requisite procedure.

The cost auditor's assessed risks may affect both the types of audit procedures to be performed and their combination. For example, when an assessed risk is high, the auditor may confirm the completeness of the terms of a contract with the counter party, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, while verifying the assessed risk of misstatement in material consumption in line with the Bill of material, the test of controls and substantive procedures may be most responsive to assess the assertions made with respect to the completeness and accuracy.

6.10.2 Timing

The cost auditor may perform tests of controls or substantive procedures at an interim date or at the period end. The higher the risk of material misstatement, the more likely it is that the cost auditor may decide it is more effective to perform substantive procedures nearer to, or at the period end rather than at an earlier date, or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of fraud. For example, the cost auditor may conclude that, when the risks of intentional misstatement or manipulation have been identified, audit procedures to extend audit conclusions from interim date to the period end would not be effective.

In addition, certain audit procedures can be performed only at or after the period end, for example:

(a) Agreeing the cost statements to the cost records;

(b) Examining adjustments made during the course of preparing the cost statements;

(c) Reconciliation of profits, or in case of an entity carrying on any activity not for profit, of surplus, as per cost accounts and as per financial accounts;

(d) Reconciliation of indirect taxes showing details of total clearance of goods/services, assessable value, duties/ taxes paid, CENVAT or VAT or Service Tax credit utilized, duties/taxes recovered and interest / penalty paid; and

(e) Statement of value addition and distribution of earnings.

6.10.3 Extent

This denotes the quantity of testing and is proportionately affected by the materiality levels and the degree of assurance the cost auditor’s plans to obtain. For example, the cost auditor may plan to increase the sample size to have a greater coverage in response to heightened risks. However, the nature of controls may influence the extent of testing, for example, in respect of an automated controls, the sample size could be considerably lower since the attribute to be tested remains consistent throughout the population.

The extent of an audit procedure is determined after considering the materiality, the assessed risk, and the degree of assurance the cost auditor plans to obtain. When a single purpose is met by a combination of procedures, the extent of each procedure is considered separately. In general, the extent of audit procedures increases as the risk of material misstatement increases. For example, in response to the assessed risk of material misstatement due to fraud, increasing sample sizes or performing substantive analytical procedures at a more detailed level may be appropriate. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is relevant to the specific risk.

In order for a plan to be effective, it needs to be dynamic, iterative and flexible to address any changed circumstance. As all matters cannot be predicted in advance, rigid adherence to the pre-determined plan without adjusting for necessary amendments will not support accomplishment of audit objectives.

6.11AUDIT CHECKLISTS

A process-oriented checklist is the most suitable for audit of the cost statement. It draws the cost auditor's attention to the key facets of the process/activity under examination, and allows the detail to reside in the documented procedure or work instruction. The process-oriented checklist emphasis is on outcomes, and they can do this all on one page.

The benefits of checklists in an audit of cost statements are:

- Encourages a structured approach to the audit of cost statements,
- Ensures that important issues are covered,
- Ensures nothing important is overlooked,
- Assists in time management throughout the audit of cost statements,
- Convenient place to record any pre-cost audit concerns,
- Convenient place to record audit evidence and observations, and
- Record of what cost auditor examined and what was found.

The documentation of the audit plan is a record of the:

- Planned nature, timing and extent of risk assessment procedures
- Further audit procedures at the assertion level in response to the assessed risk

An illustrative Audit Plan and Audit Planning schedule are explained in Appendix –IV and an illustrative Audit Checklist are specified in Appendix-V

"If you are failing to plan, you are planning to fail"

By Tariq Siddique

CHAPTER-7 AUDIT PROCEDURES

The purpose of audit procedures is to identify and assess risks of material misstatement. This is achieved through understanding the entity and its environment, including internal control. Information may be obtained from external sources, such as the Internet and trade publications, and from internal sources such as discussions with key personnel. This understanding of the entity becomes a continuous, dynamic process of gathering, updating and analyzing information throughout the audit.

Audit procedures provide audit evidence to support the assessment of risks at the cost statement and assertion levels. However, this evidence does not stand alone. Evidence obtained from risk assessment procedures is supplemented by further audit procedures (that respond to the risks identified) such as tests of controls and/or substantive procedures.

7.1 COST AUDIT PROCEDURES

The auditor uses professional judgment to determine the audit procedures to be performed, and the scope or in-depth understanding of the entity that is required. In the first year that the cost auditor conducts the audit for an entity, the work required to obtain and document this information will often require a significant amount of time. However, if the information obtained is well documented in the first year, the time required to update the information in subsequent years should be considerably less than that required in the first year.

Audit Procedures used by cost auditor to draw reasonable conclusion from the audit evidence, is obtained by the following audit procedures

(a) Risk Assessment Procedures, which comprises

- Inquires of Management and other (including inquires related to fraud)
- Observation and Inspection
- Analytical Procedures

(b) Further Audit Procedures, which comprises

- Test of Controls
- Substantive Procedures, which comprise of
    - Test of Details
    - Substantive Analytical Procedures

The cost audit procedures described in below paragraphs may be used as risk assessment procedures, tests of controls or substantive procedures, depending on the context on which they are applied by the cost auditor. Audit evidence obtained from previous cost audits may provide audit evidence where the cost auditor performs audit procedures to establish its continuing relevance. For example, in performing a previous cost audit, the cost auditor may have determined that an automated control for material consumption was functioning as intended. The cost auditor may obtain audit evidence to determine whether any changes to the automated control for material consumption have been made that may affect its continued effective functioning.

(a) **Inspection:** Inspection involves examining cost records or other related documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset (non-current and current assets). Inspection of cost records and other documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of consumption of consumables.

(b) **Observation:** Observation consists of looking at a process or procedure being performed by others, for example, the cost auditor's observation of production process affecting the input-output ratio by the entity's personnel, or of the performance of internal control activities. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

(c) **External Confirmation:** An external confirmation represents audit evidence obtained by the cost auditor as a direct written response to the cost auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain stock balances. However, external confirmations need not be restricted to stock balances only. For example, the cost auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions, for example, the absence of a "side agreement" that may influence revenue recognition.

(d) **Recalculation:** Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

(e) **Re-Performance:** Re-performance involves the cost auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

(f) **Analytical Procedures:** Analytical procedures consist of evaluation of cost information made by a study of plausible relationships among both cost and non-cost items. Analytical procedures also encompass the investigation of identified variations and relationships that are inconsistent with other relevant information or deviate significantly from predicted cost structure and may be extended to analysis of technical parameters to derive the variance.

(g) **Inquiry:** Inquiry consists of seeking information of knowledgeable persons, within the entity or outside the entity. Inquiry is used extensively throughout the cost audit in addition to other cost audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

Important Definitions

Analytical Procedures: means evaluation of cost information through analysis of possible relationship among both cost and non-cost data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Substantive Procedure: Substantive procedures are intended to create evidence that an auditor assembles to support the assertion that there are no material misstatements in regard to the completeness, validity, and accuracy of the cost records of an entity. Thus, substantive procedures are performed by an auditor to detect whether there are any material misstatements in transactions. It comprises of:

(i) Tests of details (of classes of transactions, account balances, and disclosures); and

(ii) Substantive analytical procedures (Substantive analytical procedures are types of analytical procedures being used as a substantive procedure to obtain evidence about particular assertions related to account balances or classes of transactions)

7.2 RISK ASSESSMENT PROCEDURES

Each of the three risk assessment procedures should be performed during the audit, but not necessarily for each aspect of the understanding required. In many situations, the results from performing one type of procedure may lead to performing another. For example, in an interview with the sales manager, an unusual but significant sales contract might be identified which allow certain post sales discounts. This could be followed up by an inspection of the actual sales contract and an analysis of the impact on sales margins or selling and distribution cost. Alternatively, findings from performing analytical procedures on preliminary operating results may trigger some questions for management. The answers to these questions may then lead to requests to inspect certain documents or observe some activities.

Inquiry of Management and Others (including inquires relating to Fraud)

Inquiry is used by the cost auditor in conjunction with other risk assessment procedures to assist in identifying risks of material misstatement.

Typically, most information from inquiries is obtained from management and those responsible for cost reporting. However, inquiries of others within the entity and employees with different levels of authority can provide a different perspective, and additional information that can be useful in identifying risks of material misstatement that may otherwise be missed. For example, a discussion with the production manager might reveal that certain transactions (late in the period) were rushed through and not recorded in accordance with the entity's standards operating policies of particular item of cost or cost heads.

An illustrative example of Risk Assessment is given in Appendix – VII

Areas of inquiry are outlined in the exhibit below.

Inquiry with	Inquiry About
Those Charged with Governance	• Environment in which the cost statements are prepared. • Oversight of management's processes for identifying and responding to the risks of fraud or error in the entity, and the internal control that management has established to mitigate these risks. • Knowledge of any actual, suspected, or alleged fraud affecting the entity. • Consider attending a meeting of those charged with governance and reading the minutes of their past meetings.
Management and those responsible for Cost Reporting	• Management's assessment of the risk that the cost statements may be materially misstated due to fraud or error, including the nature, extent, and frequency of such assessments. • Management's communication, if any, to employees regarding its views on business practices and operating cycle and behaviour.

Inquiry with	Inquiry About
	• Management's operating performance. • Management Target plans and actual results achieved during the period. • Potential for management override. • Knowledge of fraud or suspected fraud. • How cost estimates are prepared. • The cost statement preparation and review process. • Management's communication, if any, to those charged with governance.
Key Managerial Personnel or other Key Employees	• Business trends and unusual events. • The initiating, processing, or recording of complex or unusual transactions. • The extent of management override (i.e., have these employees ever been asked to override internal controls?). • The appropriateness/application of the accounting cost policies used. • Marketing strategies and sales trends. • Sales and operating performance incentives. • Contractual arrangements with customers and suppliers.

7.3 ANALYTICAL PROCEDURES

Analytical procedures used as risk assessment procedures help to identify matters that have audit implications. Some examples are unusual transactions or events, amounts, ratios, and trends.

Analytical procedures include the consideration of comparisons of the entity's cost information with, for example:

a) Comparable cost information for previous years or periods.

b) Anticipated results of the entity, such as cost of production / operation, input – output norms of major items of cost, etc.

c) Similar industry consumption norms or with industry averages of major items of cost or cost of goods sold or with other entities of comparable size in the same industry.

Analytical procedures also include consideration of relationships, for example:

a) *Among items of cost that would be expected to conform to standard consumption norms based on the entity's experience.*

b) *Between items of cost or non-cost, such as payroll costs to number of employees.*

Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to overall cost of production or operation of all products, each product, or service provided. Comparison with previous year's cost of production or operation for each product or service.

Different types of analytical procedures provide different levels of assurance. Analytical procedures involving:

- material cost % to total cost,
- material wastage as % to total input,
- contribution per unit of material used,
- production per man hour, production per employee,
- employee cost % to cost of goods sold,
- Idle hours % to total available hours,
- production per machine hour,
- growth in machine capacity utilisation,
- machine downtime ratio, break-down hours etc.

can provide persuasive evidence or may eliminate the need for further verification by means of tests of details, provided the ratios are correctly calculated.

The application of planned analytical procedures is based on the expectation that relationships among cost data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the cost auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the cost statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the cost auditor to use this data to estimate the total employee's costs for the period with a high degree of accuracy, thereby providing audit evidence for major items of cost in the cost statements and reducing the need to perform tests of details on the payroll. The use of widely recognized analysis for number of employees looking at recruitments done, number of people left, the labour turnover ratios, the data on idle time, absenteeism, manpower productivity reports, use of temporary or casual labour can often be used effectively in substantive analytical procedures to provide audit evidence to support the reasonableness of recorded costs.

In addition to being a risk assessment procedure, analytical procedures can also be used as further audit procedures in:

- Obtaining evidence about a cost statement assertion. This would be a substantive analytical procedure.
- Performing an overall review of the cost statements at, or near, the end of the audit.

Most analytical procedures are not very detailed or complex. They often use data aggregated at a high level, which means the results can only provide a broad initial indication about whether a material misstatement may exist.

The steps involved in performing analytical procedures are outlined in the exhibit below;

What to do	How to do
Identify Relationships within the data	Develop expectations about plausible relationships among the various types of information that could reasonably be expected to exist. Where possible, seek to use independent (i.e., not internally generated) sources of information. The cost and non-cost information could include: - Financial statements for comparable previous periods; - Budgets, forecasts, and extrapolations, including extrapolations from interim or annual data; and - Information regarding the industry in which the entity operates and current economic conditions.
Compare	Compare expectations with recorded amounts or ratios developed from recorded amounts.
Evaluate Results	Where unusual or unexpected relationships are found, consider potential risks of material misstatement.

The results of these analytical procedures should be considered along with other information gathered to:

- Identify the risks of material misstatement related to assertions embodied in significant cost statement items; and

- Assist in designing the nature, timing, and extent of further audit procedures.

7.3.1 Observation and Inspection

- Support the inquiries made of management and others;
- Provide additional information about entity and its environment.

Procedures	Potential Application
Observation	Consider observing: • How the entity operates and is organized; • Entity's premises and plant facilities; • Management's operating style and attitude toward internal control; • Operation of various internal control procedures; and • Compliance with key policies.
Inspection	Consider inspecting documents such as: • Business plans, strategies, and proposals; • Industry studies and media reports on the entity; • Major contracts and commitments; • Regulations and correspondence with regulators; • Cost Accounting policies and Cost records; • Internal control manuals; • Reports prepared by management (such as performance data and interim cost statements); and • Other reports, such as minutes from meetings of those charged with governance, reports from consultants, etc. (if relevant in context of audit of cost statements).

7.3.2 Other Source of Information about Risks

Other procedures performed by the auditor may be used for risk assessment purposes. Some typical examples are set out in the following exhibit.

Source	Description
Client Acceptance or Continuance	Relevant information obtained from performing preliminary procedures.

Source	Description
Previous Work	Relevant experience gained from previous engagement and other types of engagements performed for the entity. This could include: • Areas of concern in previous audits; • Weakness in internal control; • Changes in organizational structure, business processes, and internal control systems; and • Past misstatements and whether they were corrected on a timely basis.
External Information	• Inquires of the entity's external experts • Review of reports prepared by external agencies • Information industry obtained from various sources i.e. trade and economic journals, publications and internet searches.
Audit Team Discussions	Results of team discussion about the susceptibility of the entity's cost statements to material misstatements including fraud.

7.4 DESIGNING AND PERFORMING FURTHER AUDIT PROCEDURES

The nature, timing, and extent of further audit procedures are based on, and are responsive to, the assessed risks of material misstatement at the assertion level. This provides a clear linkage between the auditor's further audit procedures and the risk assessment.

The first step is to review the information obtained to date that will form the basis for the design of further audit procedures. This would include:

- The nature and the reasoning for the assessed risks (such as business and fraud risks) at both the cost statement and assertion levels;
- The items of cost, cost heads, account balances, classes of transactions, or disclosures that are material to the cost statements;
- The need (if any) to perform tests of controls. This would occur where substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level;
- The cost auditor's understanding of the control environment and control activities.

Based on the information above, the cost auditor can design the nature and extent of the further audit procedures to be performed.

7.5 TIMING OF PROCEDURES

Timing refers to when audit procedures are performed, or the period or date to which the audit evidence applies.

7.5.1 Before or at the Period End?

In most instances (particularly with small entities), audit procedures will be carried out at the period end and later. In addition, the higher the risks of material misstatement, the more likely it would be for substantive procedures to be performed nearer to, or after, the period end. In some situations, there can be some advantages to performing audit procedures before the period end. For example:

→ Helping to identify significant matters at an early stage. This provides time for the issues to be addressed and further audit procedures to be performed;

→ Balancing the audit workload by shifting some busy-season procedures to a period when there is more time;

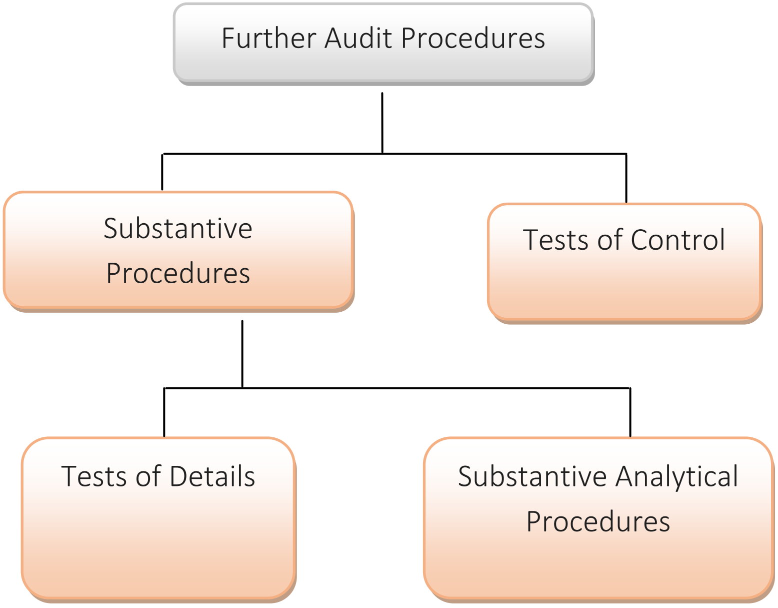
→ Balancing the auditee's workload by reducing the time required after the period end to answer audit inquiries and provide requested evidence and schedules; and

→ Performing procedures unannounced or at unpredictable times.

7.5.2 After Period End

Certain audit procedures can be performed only at, or after, the period end. This would include cut-off procedures (where there is minimal reliance on internal control), period-end adjustments, and subsequent events.

7.6 FURTHER AUDIT PROCEDURES



7.6.1 Substantive Procedures

Substantive procedures are performed by the auditor to gather evidence regarding the underlying assertions that are embedded in the items of cost, cost heads, account balances and underlying classes of transactions; and detect material misstatements.

Typical substantive procedures include selection of an account balance or a representative sample of transactions to:

- Recalculate recorded amounts for accuracy;
- Confirm existence of balances;
- Ensure transactions are recorded in the right period (cut off tests);
- Compare amounts between periods or with expectations (analytical procedures);
- Inspect supporting documentation (such as invoices or contracts);
- Observe physical existence of recorded assets (inventory control); and
- Review the adequacy of allowances made for loss of value (obsolete inventory).

7.6.2 Tests of Control

Tests of controls are performed by the cost auditor to gather evidence as to the operational effectiveness of internal control procedures that:

- Address specific assertions where reliance on controls is planned; and
- Prevent or detect/correct material errors or fraud from occurring.

Typical tests of controls include the selection of a representative sample of transactions or supporting documentation to:

- Observe the operation of an internal control procedure being performed;
- Inspect evidence that the control procedure was performed;
- Inquire about how and when the procedure was performed; and
- Re-perform the operation of the control procedure (such as where the information system is computerized).

An illustrative example of Audit Procedures is given in Appendix - VI

Relevant Requirements of SCA – 112 "Analytical Procedures" are reproduced below:

Para No	Relevant Requirement
5.1	***When designing and performing substantive analytical procedures, either alone or in combination with test of details, as substantive procedures in accordance with other SCAs, the cost auditor shall:*** **a)** ***Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;*** **b)** ***Evaluate the reliability of cost data from which the cost auditor's expectation of recorded amounts or ratios are developed, taking account of source, comparability, and nature and relevance of cost information available, and controls over preparation;*** **c)** ***Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the cost statements to be materially misstated; and*** **d)** ***Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.***
5.3	*If analytical procedures performed in accordance with this standard identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the cost auditor shall investigate such differences by:* a) *Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and* b) *Performing other audit procedures as necessary in the circumstances.*

Substantive analytical procedures involve a comparison of amounts or relationships in the cost statements with an expectation developed from information obtained from understanding the entity, and other audit evidence.

To use an analytical procedure as a substantive procedure, the auditor should design the procedure to reduce the risk of not detecting a material misstatement in the relevant assertion to an acceptably low level. This means that the expectation of what the recorded amount should be is precise enough to indicate the possibility of a material misstatement, either individually or in the aggregate.

7.6.3 Techniques

There are a number of possible techniques that can be used to perform the analytical procedures. The objective is to select the most appropriate technique to provide the intended levels of assurance and precision. Techniques include:

- Ratio analysis
- Trend analysis
- Break-even analysis
- Pattern analysis
- Regression analysis

Cost Statement Amount	Relationship and Procedures
Sales	Selling price applied to the quantities shipped
Amortization Expenses	Amortization rate applied to capital asset balances, allowing for effect of additions and disposals
Overhead Element of Inventory	Relating actual overheads to actual direct labour or production volumes
Payroll Expenses	Pay rates applied to number of employees
Commission Expenses	Commission rate applied to sales
Payroll Accounts	Daily payroll applied to number of days accrued

7.6.4 Tests of Control

Tests of controls are tests designed to obtain audit evidence about the operating effectiveness of controls. Controls can prevent material misstatements at the assertion level from occurring altogether, or detect and then correct them after they have occurred. The controls selected for testing would be those that provide necessary audit evidence for a relevant assertion.

Tests of controls are considered by the cost auditor when:

- The risk assessment is based on an expectation that internal control operates effectively; or
- Substantive procedures alone will not provide sufficient appropriate audit evidence at the assertion level.

Tests of controls are designed to obtain audit evidence about:

- How internal control procedures were applied throughout, or at relevant times during, the period under audit. If substantially different controls were used at different times during the period, each control system should be considered separately;
- The consistency with which internal control procedures were applied; and
- By whom or by what means controls were applied.

Some key factors for the auditor to consider when designing a test of controls are listed below.

Address	Description
What Risk of Material Misstatement and Assertion is being addressed?	Identify the risk of material misstatement and the related assertion that would be addressed by performing tests of control. Then consider whether audit evidence about the relevant assertion can be best obtained by a performing tests of controls or through substantive procedures.
Reliability of the Controls	As a general rule, it is not worth testing controls that may prove to be unreliable, because the small sample sizes commonly used for testing controls are based on no deviations being found. If any of the following factors are significant, it may be more effective to perform substantive procedures (if possible): • History of errors • Changes in the volume or nature of transactions • The underlying entity-level and general IT controls are weak • Controls can be (or have been) circumvented by management • Infrequent operation of the control • Changes in personnel or competence of people performing the control • There is a significant manual element in the control that could be prone to error • Complex operation, and major judgments involved with its

	operation
Existence of Controls	Does control depend on effective operation of other controls? This could include non-cost information produced by a separate process, the treatment of exceptions, and periodic reviews of reports
Nature of Test to meet Objectives	Tests of controls usually involve a combination of the following: • **Inquiries** of appropriate personnel**;** • **Inspection** of relevant documentation; • **Observation** of the company's operations; and • **Re-performance** of the application of the control. Note that inquiry alone would not be sufficient evidence to support a conclusion about the effectiveness of a control. For example, to test the operating effectiveness of internal control over material receipts, the cost auditor might observe the procedures for opening and processing material receipts. Because an observation is pertinent only at the point in time at which it is made, the auditor would supplement the observation with inquiries of entity personnel and inspection of documentation about the operation of such internal control at other times.

Tests of Control may provide evidence of effective operations;

- At a particular point in time; or
- Over a period of time, such as the period under audit.

When the tests of controls take place before the period end, the auditor would consider what additional evidence may be required to cover the remaining period. This evidence may be obtained by extending the tests to cover the remaining period, or testing the entity's monitoring of internal control.

Factors to Consider	
Gap between the Test of Control and Period End	Significance of assessed risks of material misstatement at the assertion level.
	Specific controls that were tested during the interim period.
	Degree to which audit evidence about the operating effectiveness of those controls was obtained.
	Length of the remaining period.

	Extent to which the auditor intends to reduce further substantive procedures based on the reliance on internal control.
	The control environment
	Any significant changes in internal control, including changes in the information system, processes, and personnel that occurred subsequent to the interim period.

7.7 AUDIT PROCEDURES THAT ASSIST WHEN FORMING AN OVERALL OPINION

The opinion drawn from the results of analytical procedures designed and performed are intended to corroborate conclusions formed during the cost audit of individual items of cost or cost heads or elements of the cost statements. This assists the cost auditor to draw reasonable conclusions on which to base the cost auditor's opinion.

The results of such analytical procedures may identify a previously unrecognized risk of material misstatement. In such circumstances, the cost auditor requires to revise the his assessment of the risks of material misstatement and modify the further planned audit procedures accordingly.

7.8 INVESTIGATING RESULTS OF AUDIT PROCEDURES

Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the cost auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the cost audit.

The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

What Measures Improves

By : Peter F. Drucker

CHAPTER – 8 EVALUATING INTERNAL CONTROLS

The control environment is the foundation for effective internal control, providing discipline and structure by setting the tone at the top influencing the control consciousness of the entity's personnel. The engagement team is required to understand how management and those charged with governance have created and maintained a culture of honesty and ethical behaviour, and established appropriate controls to prevent and detect fraud within the entity. The engagement team also considers matters such as the independence of the directors and their ability to evaluate the actions of management. The engagement team also considers whether there is an audit committee which understands the entity's business transactions and evaluates whether the financial / cost statements give a true and fair view.

The control environment in itself does not prevent, or detect and correct, a material misstatement in classes of transaction, account balances, and disclosures and related assertions and the engagement team should consider the control environment along with the effects of other internal control components when assessing the risk of material misstatement.

Important Definition

Control Environment- It includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment is a component of internal control.

A control including internal control is always designed to respond (mitigate) to a possible risks. A control that does not address a risk is obviously redundant. So, a risk has to exist before it can be mitigated by a management control. However, some cost auditors ignore this fact. They start their evaluation of internal control by documenting the system and controls that exist before taking the time to identify what risks actually require mitigation. This approach can result in a lot of unnecessary work in documenting processes and controls, which may later prove to be totally irrelevant to the audit objectives.

SCA -104 - ***"Knowledge of Business, its Process and the Business Environment",*** state following requirement for engagement auditor or team to obtain an understanding of the control environment.

No	Particulars
5.3	***The cost auditor shall obtain an understanding of internal controls relevant to the audit*** *(f) **Control Environment: The cost auditor shall evaluate whether management has created and maintained a culture of honesty and ethical behaviour.*** *(g) **The entity's risk assessment process: The cost auditor shall obtain an understanding of whether the entity has a process for:*** ***(5) Identifying business risks relevant to cost reporting objectives;*** ***(6) Assessing the likelihood of their occurrence;*** ***(7) Estimating the significance of the risks; and*** ***(8) Deciding about actions to address those risks.*** *(h) **Cost Information System/ Management Information System: The cost auditor shall obtain an understanding of the Information System including Management Information System, relevant to cost reporting including the following area;*** ***(5) The classes of transactions and their analysis, that are significant to the cost statements;*** ***(6) The procedures, by which those transactions and their analysis are initiated, recorded, processed, and reported in the management information systems and cost statements;*** ***(7) The related cost accounting records, supporting information that are used to initiate, record, process and report transactions; and*** ***(8) the reporting process used to prepare the entity's cost statements, including significant estimates and disclosures.*** *(i) **Control Activities: The auditor shall obtain an understanding of the control activities, relevant to the audit*** *(j) **Monitoring of controls:*** ***(3) The auditor shall obtain an understanding of the major activities, that the entity uses to monitor internal control over ;reporting.(refer 6.11)*** **(4)** ***The cost auditor shall evaluate the adequacy of the internal audit function in relation to cost records.***
5.4	***The cost auditor shall evaluate and assess:*** ***(4) IT Architecture, Systems and programmes in use in the entity;*** ***(5) Controls on access to data;***

> ***(6) Controls on changes to data in master files, systems or programmes; an***
>
> ***(4) Integrity of information and security of the data***

8.1 INTERNAL CONTROL- CORE CONCEPT

Internal Control - The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control.

Internal control is management's response intended to mitigate an identified risk factor or achieve a control objective. There is a direct relationship between an entity's objectives and the internal control it implements to ensure their achievement. Once objectives are set, it is possible to identify and assess potential events (risks) that would prevent the achievement of the objectives. Based on this information, management can develop appropriate responses, which will include the design of internal control.

Internal control objectives can be broadly grouped into four categories:

- Strategic, high-level goals that support the mission of the entity;
- Reporting (internal control over cost / financial reporting);
- Operations (operational controls); and
- Compliance with laws and regulations.

Internal control relevant to an audit of cost statements primarily pertains to cost reporting. This addresses the entity's objective of preparing cost statements for external purposes.

Operational controls, such as production and staff scheduling, quality control, and employee compliance with environmental and other regulatory requirements, would not normally be relevant to the financial audit but may be useful in audit of cost statements to determine cost centre, profit centre or process wise cost, except where:

- The information produced is used to develop an analytical procedure; or
- The information is required for disclosure in the cost statements.

For example, if production statistics were used as a basis for an analytical procedure, the controls to ensure the accuracy of such data would be relevant. If non-compliance with certain laws and regulations has a direct and material effect on the cost statements, the controls for detecting and reporting on such noncompliance would be relevant.

8.1.1 Internal Control Components

The term "internal control" as used in SCA-117 is broader than just control activities such as segregation of duties, authorizations and reconciliations, etc.

Internal control encompasses five key components:

- *The control environment*;
- *The entity's risk assessment process*; (Chapter – 11 "Audit Risk Assessment")
- *The information system, including the related business processes, relevant to cost reporting.*
- *Control activities relevant to the audit*; and
- *Monitoring of Internal Control*

The cost auditor should obtain an understanding of the major activities that the entity uses to monitor internal control relevant to cost reporting, including those related to control activities relevant to the audit, and how the entity initiates remedial actions to address deficiencies in its controls.

If an entity has an internal audit function, inquiries of the appropriate individuals within the function may provide information that is useful to the cost auditor in obtaining an understanding of the entity and its environment, and in identifying and assessing risks of material misstatement at the cost statement and assertion levels. If based on responses to the cost auditor's inquiries, it appears that there are findings that may be relevant to the entity's audit; the cost auditor may consider it appropriate to read related reports of the internal audit function.

8.1.2 Understanding of Control Activities

While understanding controls that are relevant to the audit, cost auditor should evaluate the design of those controls and determine whether they have been implemented properly, by performing procedures in addition to discussions with the entity's personnel.

The cost auditor should understand the related cost accounting records, supporting information, and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred primarily to the accounting system and subsequently to cost accounting statement.

The cost auditor should obtain an understanding of control activities relevant to cost/ management information system in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions and disclosure in the cost statements or to every assertion relevant to them.

If the entity has established risk assessment process, the cost auditor should obtain an understanding of it, and the results thereof. If the cost auditor identifies risks of material misstatement that management failed to identify, the cost auditor should evaluate whether there was an underlying risk of a kind that the cost auditor expects would have been identified by the entity's risk assessment process. If there is such a risk, the cost auditor should obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or determine if there is a significant deficiency in internal control with regard to the entity's risk assessment process.

An understanding of the business risks facing the entity increases the likelihood of identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the cost statements. However, the cost auditor does not have a responsibility to identify or assess all business risks because not all business risks give rise to risks of material misstatement. The cost auditor should obtain an understanding of control activities relevant to cost/ management information system in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to the assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions and disclosure in the cost statements or to every assertion relevant to them.

8.1.3 IT Environment and Controls

The engagement team should obtain an understanding of how the entity has responded to risks arising from the use of Information Technology [IT]. The use of IT affects the way that control activities are implemented. The engagement team considers whether the entity has responded adequately to the risks arising from IT by establishing effective general IT-controls and application controls. From the engagement team's perspective, controls over IT systems are effective when they maintain the integrity of information and the security of the data such systems process. General IT-controls are policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems.

The cost auditor should assess the following with regard to IT environment and controls.

5 Reliance on systems or programs that are inaccurately processing data, or processing inaccurate data, or both.

6 Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.

7 The possibility of IT personnel gaining access to privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.

8 Unauthorized changes to data in master files.

9 Unauthorized changes to systems or programs.

10 Failure to make necessary changes to systems or programs.

11 Inappropriate manual interventions.

12 Potential loss of data or inability to access data as required.

8.1.4 Framework for Assessing Controls

Tests of control can be grouped under the following headings:

- Tests by observation
- Tests by enquiry
- Tests involving inspection of documentary evidence
- Tests by re-performance

8.2 CONTROLS RELEVANT TO COST AUDIT

Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organizational and functional levels. Examples of specific control activities include those relating to the following:

- Authorization (Management Controls)
- Performance reviews
- Information processing (IT Controls)
- Physical controls (Application Controls)
- Segregation of duties

The entity's controls relate to financial reporting, cost reporting, operations, and compliance controls. However, not all the controls are relevant to the engagement team's risk assessment. Usually the controls relevant to a cost audit are those relating to the entity's objective of preparing cost statements for external purposes that give a true and fair view in accordance with the applicable cost reporting framework and the management of risk that may give rise to a material misstatement.

Risks at the cost statement level may derive in particular from a deficient control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as management's lack of competence may have a more pervasive effect on the cost statements and may require an overall response by the auditor.

Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.

Management's monitoring of controls includes considering whether they are operating as intended and that they have modified as appropriate for changes in conditions. Monitoring is done also to ensure that controls continue to operate effectively over time. For example, if the timeliness and accuracy of reconciliations of cost and financial results are not monitored, personnel are likely to stop preparing them.

Factors relevant to the cost auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

- Materiality
- The significance of the related risk
- The size of the entity
- The nature of the entity's business, including its organization and ownership characteristics
- The diversity and complexity of the entity's operations
- Applicable legal and regulatory requirements
- The circumstances and the applicable component of internal control
- The nature and complexity of the systems that are part of the entity's internal control, including the use of service organizations
- Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement

Relevant Requirement of ***SCA – 117 "Identifying and Assessing the Risks of Material Misstatements"***related to *"Control Activities Related to Audit and its Monitoring"*

No	Particulars
5.10	***The cost auditor shall obtain an understanding of control activities relevant to the cost audit, being those the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions, and***

	disclosure in the cost statements or to every assertion relevant to them.
5.11	***In understanding the entity's control activities, the auditor shall obtain an understanding of how the entity has responded to risks arising from IT***
5.12	***The cost auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control relevant to cost reporting, including those related to those control activities relevant to the audit, and how the entity initiates remedial actions to deficiencies in its controls.***
5.13	***If the entity has an internal audit function, the cost auditor shall obtain an understanding of the nature of the internal audit function's responsibilities, its organizational status, and the activities performed, or to be performed.***
5.14	***The cost auditor shall obtain an understanding of the sources of the information used in the entity's monitoring activities, and the basis upon which management considers the information to be sufficiently reliable for the purpose.***

The engagement team should obtain the understanding on the following controls.

8.2.1 Performance Reviews

These control activities include reviews and analyses of actual performance versus budgets, standards, and prior period performance; relating different sets of data – operating or cost – to one another, together with determination/ analyses of the variances and investigative and corrective actions; comparing internal data with external sources of information (job work from or to third party); and review of functional or activity performance.

8.2.3 Management Controls

Management controls and reviews by independent persons are designed to detect errors. Examples include reviewing cost information, exception reports and reconciliations.

Management controls also include authorisation, which is the approving of all transactions by a responsible person. In smaller entities, each transaction may be individually authorised. In larger entities, the authorisation procedures may be more broadly based e.g. an approved budget within which the budget holder can authorise the expenditure, or an assistant authorising consumption of raw material at shop floor within the authorised parameters of plant, quality and consumption.

8.2.4 Segregation

The key aim of segregation of duties is that no one person should be in a position to control all stages of the processing of a transaction which include:

- Initiating transactions;
- Recording transactions;
- Handling material receipts and issue; and
- Custody of Inventory.

8.2.5 Information Processing

The two broad groupings of information systems control activities are application controls, which apply to the processing of individual applications, and general IT controls, which are policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. Examples of application controls include checking the arithmetical accuracy of records, maintaining and reviewing cost control accounts, automated controls such as edit checks of input data and numerical sequence checks, and manual follow-up of exception reports. Examples of general IT controls are program change controls, controls that restrict access to programs or data, controls over the implementation of new releases of packaged software applications, and controls over system software that restrict access to or monitor the use of system utilities that could change data or records without leaving an audit trail.

8.2.6 Application Controls

These are specific controls in automated or manual procedures that are preventive or detective in nature and are designed to ensure the integrity of the cost accounting records that transactions are completely and accurately recorded. Such controls are designed to:

- ensure invalid items are rejected in processing, or
- transferred to suspense files, or
- reported to the user by means of an exception report.

When evaluating application controls, the engagement team should examine the procedures for resubmitting or otherwise dealing with rejected items and for preventing duplicate recording.

Application controls can be grouped under the following headings:

- Completeness controls
- Accuracy controls
- Maintenance controls

8.2.7 Completeness Controls

Completeness controls are designed to ensure all transactions are recorded. These are normally based on establishing an open item within the accounting system which cannot be cleared until all aspects of the transaction have been completed. For example, in a production cycle, this includes ensuring that the every material consumption is recorded, the inventory is updated and the cost of production account is updated simultaneously. Another more general example is a numerical sequence test such as sequential invoice numbering for expenses or cost recorded. Completeness procedures must be comprehensive such as covering customer claims for credit notes and claims on suppliers for faulty goods.

8.2.8 Accuracy Controls

Accuracy controls are designed to ensure entries within the accounting records are accurate. The system should cover data input and subsequent processing such as checking calculations, additions and analysis. In an automated environment, this check is often carried out in conjunction with programmed procedures.

8.2.9 Maintenance Controls

Maintenance controls are controls designed to ensure that files can only be altered by transactions processed through properly controlled procedures. Maintenance controls should also ensure that the correct copy of a computer file is used when restoring from a back-up file.

A review of application controls should start either with the transaction or the originating document. The identification of detailed controls will often not be straightforward.

8.2.10 General IT Controls

General controls governing IT operations need to be examined, so as to form a view onthe overall integrity and the programs. General controls are the controls which relate to the environment within which computer based accounting systems are developed, maintained and operated. These include:

- ✓ Controls over the reliability of processing information
- ✓ Controls over the integrity of data input and output
- ✓ Controls over the integrity of programs used
- ✓ Controls over computer system development and implementation

From the cost auditor’s perspective, controls over IT systems are effective when they maintain the integrity of information and the security of the data such systems process, and include effective general IT controls and application controls. General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They are applied apply to mainframe, and end-user environments. General IT controls that maintain the integrity of information and security of data commonly include controls over the following:

- Data centre and network operations
- System software acquisition, change and maintenance
- Program change
- Access security
- Application system acquisition, development, and maintenance

8.3 MANUAL VERSUS AUTOMATED CONTROLS

For most of entities, the system of internal control will consist of a mixture of manual and automated controls. The illustrative risk and benefit associated with different types of control are outlined below.

Manual Control	Automated Control
Benefits	
• Used to monitor the effectiveness of automated controls i.e. allocation of cost. • Suited to areas where judgment and discretion are required over large, unusual, or non-recurring transactions i.e. apportionment of deprecation for common machinery for various products. • Beneficial when errors are difficult to define, anticipate, or predict i.e. Budgets. • Changing circumstances may require a control response outside the scope of an existing automated control i.e. calculation of abnormal cost.	• Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data. i.e. cycle time. • Enhance the timeliness, availability, and accuracy of information i.e. real time transactions. • Facilitate the additional analysis of information i.e. variance analysis. • Enhance the ability to monitor the performance of the entity's activities and its policies and procedures i.e. profit centre analysis. • Reduce the risk that internal control will be circumvented i.e. leakage to inventory. • Enhance the ability to achieve effective segregation of duties by implementing appropriate system access restrictions in applications, databases, and operating systems i.e. authorization for transaction processing.
Risks	

<table>
<tr><th>Manual Control</th><th>Automated Control</th></tr>
<tr><td>Less reliable than automated controls, as performed by people.
More easily bypassed, ignored, or overridden.
Prone to simple errors and mistakes.
Consistency of application cannot be assumed.
Less suitable for high volume or recurring transactions where automated controls would be more efficient.
Less suitable for activities where specific ways to perform the control can be adequately designed and automated.</td><td>Reliance can be placed on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
Unauthorized access to data may result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions (particular risks may arise where multiple users access a common database).
The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby breaking down the segregation of duties.
Unauthorized changes to data in master files.
Unauthorized changes to systems or programs.
Failure to make necessary changes to systems or programs.
Inappropriate manual intervention.
Potential loss of data or inability to access data as required.</td></tr>
</table>

8.4 EVALUATION OF INTERNAL CONTROL

Regardless of whether tests of controls will ultimately be performed to gather audit evidence, it is still necessary for the cost auditor on every engagement to evaluate control design and implementation. This involves a four-step process, which can be summarized as follows.

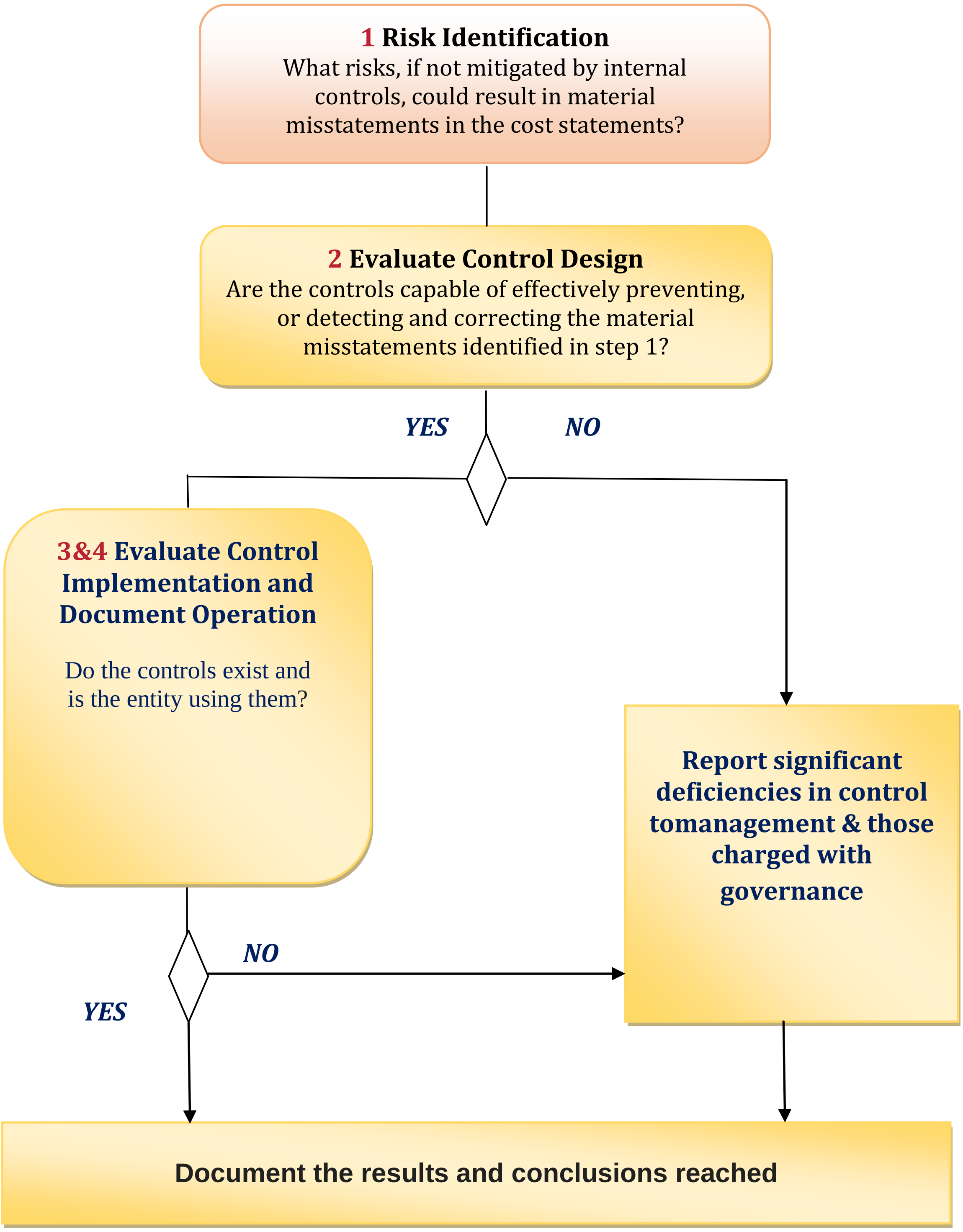
Steps	Description
1. What risks require mitigation?	Identify the inherent risks of material misstatement (business and fraud risks), and whether they are pervasive risks affecting all assertions, or specific risks that affect particular cost statement areas and assertions i.e. absorption of full overheads in under utilization of capacity, or capital expenditure absorbed

	as revenue expenditure, for example,consumption of capital spares driving long term benefits.
2. Do the controls designed by management mitigate the risks?	Identify what business processes are in place (if any). • Interview entity personnel to identify what controls mitigate the risks identified in **Step 1** above. • Review results and assess whether the controls do in fact mitigate the risks. • Communicate any significant deficiencies identified in the entity's internal control to management and those charged with governance.
3. Are the controls that mitigate the risks factors in operations?	Observe or inspect the operation of relevant internal controls to ensure that they have indeed been implemented. Note that inquiry of management is not sufficient to evaluate whether a relevant control has in fact been implemented i.e. complete set of transactions are recorded but not on real time basis provide risk of material misstatement. This step can often be combined with **Step 2** above.
4. Has the operationof relevant controls been documented?	This step can consist of a simple narrative description of the major processes (prepared by the entity's management or auditor), describing the operation of the relevant internal controls identified.This documentation does *not* have to include: • A detailed description of the business process or the way paper flows through the entity; or • Internal controls that may exist but are not relevant to the audit.

8.5 LIMITATION ON INTERNAL CONTROL

Regardless of how well a control is designed and implemented, it can only provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of cost reporting due to certain inherent limitations. These are described below.

- Human judgments and simple human failures such as errors or mistakes
- Circumvention of internal control by the collusion of two or more people
- Inappropriate management override of internal control, such as posting of consumption through Journal Voucher, or revising the terms of a sales contract or overriding a system's authorization limit



8.6 WRITTEN REPRESENTATIONS ABOUT INTERNAL CONTROL

Written representations should be obtained from management acknowledging its responsibility for such internal control as management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error.

8.7 DOCUMENTATION RELATED TO INTERNAL CONTROL

The specific documentation about Internal Control will help cost auditor to;

- Understand the nature, operation (initiation, processing, recording, etc.), and context (such as who performs the control, where the control is performed, how often and the resulting documentation) of the identified controls; and
- Determine whether the controls are likely to be reliable and operate effectively. If so, they could be tested as part of the audit response to the assessed risks. If a decision is made to test the operating effectiveness of controls, this documentation will also help the auditor in designing the test, such as what population to use in selecting the sample, what control attributes to examine, who performs the control, and where the necessary documentation may be found.

8.8 DOCUMENTING RELEVANT INTERNAL CONTROL

- How significant transactions are initiated, authorized, recorded, processed are reported i.e. Bill of Material;
- The flow of transactions in sufficient details to identify the points at which material misstatement caused by error or fraud could occur i.e. overhead rate; and
- Internal Control over the period end cost reporting process, including accounting estimates and disclosures i.e. adjustments through journal voucher, provision or written off expenditure.

The most common forms of documentation prepared by management or the cost auditor are:

- Narrative descriptions or memoranda;
- Flow charts;
- A combination of flow charts and narrative descriptions; and
- Questionnaires and checklists.

The nature and extent of the documentation required is a matter of professional judgment. Factors to consider include:

- The nature, size, and complexity of the entity and its internal control,
- Availability of information from the entity, and
- Audit methodology and technology used in the course of the cost audit.

The extent of documentation may also reflect the experience and capabilities of the audit team. An audit of cost statements undertaken by a less experienced team may require more detailed documentation to assist them in obtaining an appropriate understanding of the entity than a team composed of more experienced individuals.

8.9 COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL

The cost auditor responsibilities also includes to communicate appropriately to those charged with governance and management deficiencies in internal control that the cost auditor has identified in an audit of cost statements. Nothing precludes the cost auditor from communicating to those charged with governance and management other internal control matters that the cost auditor has identified during the audit.

For example: The Companies Act, 2013 also casts immense responsibility on the practicing cost accountants (PCMAs) that they must take care while conducting cost audits. Any failure or lapse on the part of cost auditor may attract penalty for incorrect report and disciplinary action for professional or other misconduct under the provisions of the Cost and Works Accountants Act.

Deficiency in Internal Control: *This exists when:*

(a) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the cost statements on a timely basis; or

(b) A control necessary to prevent, or detect and correct, misstatements in the cost statements on a timely basis is missing.

Significant Deficiency in Internal Control:*A deficiency or combination of deficiencies in internal control that, in the cost auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.*

The significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may therefore exist even though the cost auditor has not identified misstatements during the cost audit.Indicators of significant deficiencies in internal control include, for example:

(a) Evidence of ineffective aspects of the control environment, such as:

- (i) Indications that significant transactions in which management is financially interested are not being appropriately scrutinized by those charged with governance.
- (ii) Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
- (iii) Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.

(b) Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.

(c) Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the cost auditor would expect the entity's risk assessment process to have identified.

(d) Evidence of an ineffective response to identified significant risks (for example, absence of controls over such a risk).

(e) Misstatements detected by the cost auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.

(f) Restatement of previously issued cost statements to reflect the correction of a material misstatement due to error or fraud.

(g) Evidence of management's inability to oversee the preparation of the cost statements.

SCA-116 " Communicating Deficiencies in Internal Control to Those charged with Governance and Management" *stipulated certain relevant requirements for communication of deficiencies in control environment are reproduced below;*

No.	Particulars
5.3	***The cost auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis.***
5.4	***The cost auditor shall also communicate to management at an appropriate level of responsibility on a timely basis:*** ***(a) In writing, significant deficiencies in internal control that the cost auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances; and*** ***(b) Other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the cost auditor's professional judgment, are of sufficient importance to merit management's attention.***
5.5	***The cost auditor shall include in the written communication of significant deficiencies in internal control:*** ***(a) A description of the deficiencies and an explanation of their potential effects; and*** ***(b) Sufficient information to enable those charged with***

	governance and management to understand the context of the communication. In particular, the cost auditor shall explain that: ***(i) The purpose of the audit was for the cost auditor to express an opinion on the cost statements;*** ***(ii) The audit included consideration of internal control relevant to the preparation of the cost statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control; and*** ***(iii) The matters being reported are limited to those deficiencies that the cost auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.***

Law or regulation in some jurisdictions may establish a requirement (particularly for cost audits of regulatory entities) for the cost auditor to communicate to those charged with governance or to other relevant parties (such as regulators) one or more specific types of deficiency in internal control that the cost auditor has identified during the cost audit. Where law or regulation has established specific terms and definitions for these types of deficiency and requires the cost auditor to use these terms and definitions for the purpose of the communication, the cost auditor uses such terms and definitions when communicating in accordance with the legal or regulatory requirement.

Where the jurisdiction has established specific terms for the types of deficiency in internal control to be communicated, but has not defined such terms, it may be necessary for the cost auditor to use judgment to determine the matters to be communicated further to the legal or regulatory requirement. In doing so, the cost auditor may consider it appropriate to have regard to the requirements and guidance in this SCA.

For example, if the purpose of the legal or regulatory requirement is to bring to the attention of those charged with governance certain internal control matters of which they should be aware, it may be appropriate to regard such matters as being generally equivalent to the significant deficiencies required by this SCA to be communicated to those charged with governance, for example,requirements under section 143(12) of the Companies Act,2013.

8.9.1 Assessing the Severity of a Deficiency

Less serious or even minor control deficiencies may also be identified during the course of the cost audit. These could result from interviews with management and staff, observation of internal controls in operation, performing further audit procedures, and any other information that may be obtained. It is a matter of professional judgment whether these matters are of sufficient importance to be reported to management and those charged with governance.

A 'deficiency' in internal control over cost reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A 'significant deficiency' is a deficiency, or a combination of deficiencies, in internal control over cost reporting that is important enough to merit attention of those charged with governance since there is a reasonable possibility that a misstatement of the company's annual or interim cost statements will not be prevented or detected on a timely basis.

A deficiency in design exists when a control necessary to meet the control objective is missing or an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively. A 'material weakness' is a deficiency, or a combination of deficiencies, in internal controls over cost reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim cost statements will not be prevented or detected on a timely basis.

The severity of a deficiency depends on whether there is a reasonable possibility that the company's controls will fail to prevent or detect a misstatement of an account balance or items of cost or disclosure; and the magnitude of the potential misstatement resulting from the deficiency or deficiencies.

Examples of matters that the cost auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

(a) The likelihood of the deficiencies leading to material misstatements in the measurement, classification, allocation, apportionment, and absorption of costs.

(b) The susceptibility to loss or fraud relating to misappropriation of assets or over-valuation or under-valuation of inventories.

(c) The subjectivity and complexity in determining the quantity or value of consumption of raw materials, utilities and other inputs effecting true and fair value of cost of production or operations, cost of sales and margin for each product or service.

(d) The volume of activity that has occurred or could occur in the items of cost exposed to the deficiency or deficiencies.

(e) The importance of the controls to the cost reporting framework; for example:

(i) General monitoring controls (such as oversight of management);
(ii) Controls over the prevention and detection of fraud;
(iii) Controls over the selection and application of cost accounting policies;
(iv) Controls over significant transactions with related parties;
(v) Controls over the significant management estimates;
(vi) Controls over significant transactions outside the entity's normal course of business; and
(vii) Controls over the period-end cost reporting framework.

8.9.2 Documenting Control Deficiencies

There are no specific requirements in the SCAs as to how control deficiencies are to be documented. The extent of documentation is a matter requiring professional judgment. Where the audit team is less experienced, more detailed documentation and guidance may be required than where the team consists of highly experienced individuals.

A possible approach to documenting deficiencies as they are identified is outlined below. This documentation can be used for:

- Discussing deficiencies with management;
- Assessing the severity of the deficiencies;
- Considering the need for any additional audit procedures to respond to the unmitigated risk; and
- Preparing the required communication to management and those charged with governance.

An example of such documentation is illustrated below (without the references to supporting and other working papers).

What is the risk factor or assertion affected	Describe the deficiency identified	What is the potential effect on cost statements	Significant Deficiency (Yes / No)	Response
Management has not considered or assessed the risks of fraud occurring	Members of themanagement teamtrust each otherand are reluctantto introduce effective & costlypolicies, i.e. Standard Operating	Management could override controls and materially manipulate the cost statements	Yes	See the specific procedures performed on journal entries, consumptions, related parties, and treatment of revenue

	Procedures (SOPs) thataddress the risk ofmaterial misstatements or fraud			
Payroll / Labour Cost recorded in wrong accounting period	There are no controls to prevent this from occurring and we found a number of cutoff errors in our tests of details	Labour Cost could be materially misstated in the cost statements	Yes	See the additional audit procedures performed relating to cut off.
Poor oversight and documentation to support the preparation of cost estimates	The entity provide virtually no backup documents to support cost estimates	Given the size of the cost estimates, an error could result in a material error in the cost statements	Yes	Obtain evidence to support to assumptions and perform the calculation gain

8.9.3 Oral Discussion with Management

Before issuing a written communication, it is generally considered best practice to discuss the findings orally (such as a discussion based on a draft letter) with the appropriate person or level of management, and possibly with those charged with governance. The appropriate person is the one who can evaluate the deficiencies and take the necessary remedial action. This step helps the cost auditor to ensure that the findings are factually correct and appropriately worded in the circumstances. It may also enable the cost auditor to obtain a preliminary indication of management's response to the findings.

For significant deficiencies, the appropriate level of management would be the highest in the entity, such as the owner-manager, chief executive officer, or chief financial officer (or equivalent). For other deficiencies, the appropriate level may be operational management with direct involvement in the control areas affected. Please note that, if all of those charged with governance are also involved in managing the entity, communication with the most senior management may not adequately inform all those with governance responsibilities.

If the deficiency is directed at management directly (e.g., a question about its integrity or competence), it would not be appropriate to discuss this with management directly. The discussion of such findings would normally be with those charged with governance.

The discussion with management provides an opportunity to discuss the findings and obtain management's reaction before the findings are finalized and communicated in writing, as illustrated below.

<table>
<tr><th colspan="2">Benefits</th></tr>
<tr><td rowspan="3">Discussion with Management</td><td>Alerts management, on a timely basis, to the existence of deficiencies.</td></tr>
<tr><td>Opportunity to obtain relevant information for further consideration, such as:
• Confirmation that the description of the deficiency and related facts (such as the extent of an actual misstatement) is accurate;
• Existence of other possibly compensating controls;
• Management's reaction and understanding of the actual or suspected causes of the deficiencies; and
• Existence of exceptions arising from the deficiencies that management has noted.</td></tr>
<tr><td>Obtain a preliminary management response to the findings.</td></tr>
</table>

8.9.4 Written Communication

Significant deficiencies are to be reported in writing. This reflects the importance attached to such matters, and may assist management and those charged with governance in fulfilling their various responsibilities

As soon as practicable after concluding that significant deficiencies exist, the cost auditor would discuss them with management and then communicate them in writing to those charged with governance. Although not required, the communication letter may also contain some suggested recommendations for remedial action. By taking these steps, management can take corrective action on a timely basis.

8.9.5 Content of Communication

The communication of significant deficiencies would normally include:

- Description of the nature of each significant deficiency and the potential effects; there is no need to quantify those effects;

- Any suggestions for remedial action on the deficiencies;
- Management's actual or proposed responses; and
- A statement as to whether or not the auditor has undertaken any steps to verify whether management's responses have been implemented;
- An indication that, if the cost auditor had performed more extensive procedures on internal control, the cost auditor might have identified more deficiencies to be reported, or concluded that some of the reported deficiencies need not in fact have been reported; and
- An indication that such communication has been provided for the purposes of those charged with governance, and that it may not be suitable for other purposes.

8.9.6 Timing of the Written Communication

The cost auditor is required to communicate, in writing, significant deficiencies in internal control identified during the cost audit to those charged with governance on a timely basis. Factors to consider include:

- Would undue delay in the reporting of information cause it to lose its relevance?
- Would the information be an important factor in enabling those charged with governance to discharge their oversight responsibilities?

Unless law or regulations specify a particular date, the latest date that a written communication may be issued is before the date of the cost auditor's report or shortly thereafter. As the written communication forms part of the audit file, this enables the cost auditor to complete the assembly of the final audit file on a timely basis.

8.9.7 Management's Response to the Communication

It is the responsibility of management and those charged with governance to respond appropriately to the auditor's communication about significant deficiencies in internal control, and any recommendations for remedial action. This may take the form of:

- Initiating remedial action to correct the deficiencies identified by the auditor;
- A decision not to take any action;management may already be aware of the significant deficiencies, and has chosen not to remedy them because of the costs or other considerations; or
- No action at all;this may be indicative of a poor attitude toward internal control, which has implications for assessing risk at the cost statement level. In some situations, such non-action may constitute a significant deficiency in itself.

Regardless of what action is taken by management, the cost auditor is required to communicate all significant deficiencies in writing. This includes significant deficiencies already reported in prior periods. It is not the cost auditor's role to determine whether the cost of mitigating a deficiency outweighs the benefit to be obtained. However, some consideration of proportionality to the size of the entity and the application of common sense in the circumstances is appropriate.

If a previously communicated significant deficiency remains, the current period's communication may repeat the description or simply refer to the previous communication.

If the deficiency is not significant, there is no need to put it in writing or to repeat the communication in the current period. However, it may be appropriate for the auditor to re-communicate the other deficiencies if there has been a change in management, or if new information has come to the auditor's attention.

Law and Regulations Control the Lesser Man.....

Right Conduct Controls the Greater One.

By Mark Twain

CHAPTER-9 COMMUNICATIONS AND REPRESENTATIONS

Communication and Representation are the two important element of audit process, which enable the cost auditor to seek information, opinion, assertion, defining scope, defining responsibility, and represent the significant audit findings during the course of audit of cost statements on which audit opinion is based

During the course of audit of cost statements, management and cost auditor will make number of communication and verbal as well as written representations to each other.

9.1 ROLE OF COMMUNICATION AND WRITTEN REPRESENTATION

Matters to be Communicated	Matters to be Represented
Audit Matters of Governance interest include: • Auditor's responsibilities in relation to the cost statements, which also includes firming and expressing an opinion on the cost statements that have been prepared by the management with the oversight of those charged with governance. • Planned scope and timing of the audit include obtain input from those charged with governance. • Significant findings arising from audit of cost statements.	*Auditor is required to request management to provide a written representation that:* • It has fulfilled its responsibility for the preparation of cost statements in accordance with the applicable cost reporting framework. • It has provided the cost auditor with all information and access as agreed in the terms of audit engagement; and • All transactions have been recorded and are reflected in the cost statements.

Written representations are requested by the auditor from those responsible (usually management but, depending on the entity and any relevant law or regulation, may extend to those charged with governance) for the preparation of the cost statements.

9.2 MANAGEMENT VIS-À-VIS' THOSE CHARGED WITH GOVERNANCE

The clear cut definition of Management and Those charged with governance has remained the point of discussion as they were not clearly provides the distinction between both the terminologies. Let us understand the meaning of both the terminologies with the help of their definition and distinction made below:

Important Definitions

Management: ***The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance.***

Those charged with governance: ***The person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process and cost reporting framework. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.***

A distinction between Management and Those Charged with Governance

Management	Those Charged with Governance [TCWG]
Management comprises of officers and others who also perform senior managerial functions. Management includes TCWG only in those instances when they perform such functions.	TCWG describes the role of persons entrusted with the supervision, control, and direction of an entity. TCWG ordinarily are accountable for ensuring that the entity achieves its objectives, financial and cost reporting, and reporting to interested parties as well. TCWG include management only when it performs such functions.
Management refers to those persons within the entity who are having the executive responsibility about the code of conduct of the entity. For e.g. Board of Directors	TCWG refers to those persons within entity who are having the following responsibilities; a) Accountability of the entity; and b) Strategic direction of the entity. For e.g. Various committees of Board of Directors such as Audit committee, Remuneration committee, Shareholders committee etc.
Management means such personnel	Those charged with governance means such

who are responsible to perform day to day functions of the business and are responsible for making cost statements.	personnel who supervise the work done by entity and are responsible for approving cost statements.
Management is also known as *Policy Implementing Body*	TCWG is also known as *Policy Making Body*
Note: It should be noted that in respect of small entities, both management and TCWG lies in same hands	

9.3 COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE (SCA- 115)

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 comprises 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).

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, the cost auditor's communications may be directed to a subgroup of those charged with governance. In these cases, the cost auditor would determine whether there is also a need to communicate with the entire governing body. This would be based on:

- The respective responsibilities of the subgroup and the governing body;
- The nature of matter to be communicated;
- Relevant legal or regulatory requirements; and
- 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.

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 his 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 audit engagement that, unless prohibited by law or regulation, the cost auditor retains the right to communicate directly with the governing body.

Audit committees (or similar sub-groups 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.

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).

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.

9.3.1 Relevant Requirements of SCA -115 "Communication with Those Charged with Governance", 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 audit of cost statements;

c) To provide those charged with governance with timely observation arising from the audit that are significant and relevant to their responsibility to oversee the cost reporting process;

d) To promote the effective two way communication between the cost auditor and those charged with governance.

Para	Relevant Requirement
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.***
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.***
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;*** ***(b) Significant difficulties, if any, encountered during the cost audit;***

Para	Relevant Requirement
	(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*** ***(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.***
5.8	***The cost auditor shall communicate with those charged with governance the form, timing and expected general content of communications.***
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.***
5.12	***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.***
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.***

9.3.2 Matters to be Communicated

The cost auditor's responsibilities in relation to audit of the cost statements are often included in the audit engagement letter or other suitable form of written agreement that records the agreed terms of the audit 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.

9.3.3 Matters Communicated may include:

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

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

(i) 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.

(ii) The views of those charged with governance of:

a) the appropriate persons(s) in the entity's governance structure with whom to communicate;

b) the allocation of responsibilities between those charged with governance and management;

c) the entity's objectives and strategies, and the related business risks that may result in material misstatements;

d) matters those charged with governance consider warrant particular attention during the cost audit, and any areas where they request additional procedures to be undertaken;

e) significant communications with regulators; and

f) Other matters that those charged with governance consider may influence the audit of cost statements.

(iii) The attitudes, awareness, and action of those charged with governance concerning;

(a) The entity's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness on internal control.

(b) The detection or possibility of fraud.

(iv) The actions of those charged with governance in response to developments in cost accounting standards, corporate governance practices, and other related matters.

(v) The responses of those charged with governance to previous communications with the cost auditor.

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.

Some of the more common matters of governance interest that may be communicated (preferably in writing) are outlined in the following exhibit.

Matter	Communication Considerations
Cost Accounting Policies	The selection of (or changes in) significant cost accounting policies and practices that have or could have a material effect on the entity's cost statement.
Previous Period Communications	Matter of governance interest previously communicated that could have an effect on the current period's cost statements.
Risks of Material Misstatements	The potential effect on the cost statements of any material risk (such as pending litigations) that require disclosure in the cost statements.
Material Uncertainties	Material uncertaintiesrelated to events and conditions that may cast significant doubt on the entity's ability to continue as going concern.
Concerns	Business conditions affecting the entity and its business plans to

Matter	Communication Considerations
	strategies that may affect the risks of material misstatement. Concern about management's consultations with other cost accountants on cost accounting or auditing matters.
Significant Difficulties Encountered	This could include: • Resolutions of difficult cost accounting or auditing issues; • Unavailable data and documents required for cost audit; • Personnel unable to answer questions; • Scope limitations and how they were resolved; and • Disagreements with management about the matters that, individually or in aggregate, could be significant to the entity's cost statements or the cost auditor's report.
Comments on Entity Management	Question regarding management's competence; • Significant deficiencies in internal control; • Question regarding management's integrity; • Significant transactions with related parties; • Illegal acts; and • Fraud involving management.
Audit Adjustments	Uncorrected audit adjustments that have or could have a material effect on the entity's cost statements.
Uncorrected Misstatements	Uncorrected misstatements that were determined by management to be immaterial (other than trivial amounts), both individually and in the aggregate, to the cost statement taken as whole.
The Cost Auditor's Report	Outline the reasons for any expected modifications to the cost auditor's report.
Agreed upon Matters	Any other matters agreed upon in the term of the audit engagement.
Other Matters	Other matters, if any, arising from the audit of cost statement that, in the auditor's professional judgement, are significant to the oversight of the cost reporting process.

9.3.4 Communication Regarding the Qualitative Aspects of Cost Accounting Practices

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 VIII identifies Qualitative aspects & matters that may be included in this communication.

9.3.5 Significant Difficulties Encountered During the Cost Audit

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.

9.3.6 Significant Matters Discussed, or Subject to Correspondence with Those Charged With Governance

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.

9.4 THE COMMUNICATION PROCESS

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.

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.

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.

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.

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.

9.4.1Forms of Communication

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. 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.

9.4.2 Timing of Communications

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.

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 non-compliance with a law, in time for preventive action to be taken, but communication of the matter may enable remedial action to be taken.

9.4.3 Adequacy of Communication Process

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.

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 Cost Audit Branch, 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.

9.5 DOCUMENTATION

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

9.6 WRITTEN REPRESENTATION (SCA-110)

Written representations are an important source of cost audit evidence. If management modifies or does not provide the requested written representations, it may alert the cost auditor to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

Audit evidence is the information used by the auditor in arriving at the conclusions on which the cost auditor's opinion is based. Written representations are necessary information that the cost auditor requires in connection with the audit of the entity's cost statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.

Written Representation: A written statement by management provided to the cost auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, cost statements, the assertions therein, or supporting books and records.

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the cost auditor obtains about the fulfilment of management's responsibilities, or about specific assertions.

9.6.1 From Whom Written Representation Requested

Written representations are requested from those responsible for preparation of the cost statements. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation; however, management (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer, or other equivalent persons in entities. In some circumstances, however, other parties, such as those charged with governance, are also responsible for the preparation of the cost statements.

Due to its responsibility for the preparation of the cost statements, maintenance of cost records and treatment of items of cost in cost statements, management is expected to have sufficient knowledge of the processes followed by the entity in preparing the cost statements and the assertions therein on which to base the written representations. In some cases, however, management may decide to make inquiries of others who participate in preparing and presenting the cost statements and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested. Such individuals may include:

- An actuary responsible for actuarially determined cost accounting measurements.
- Expertise of engineers of the plant in understanding the production process including cycle time for production.
- Expertise of Engineers who are responsible and specialize in quality control.

In some cases, management may include in the written representations qualifying language to the effect that representations are made to the "best of its knowledge and belief". It is reasonable for the cost auditor to accept such wording if the cost auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.

Relevant Requirements of SCA -110 "*Written Representation*" is reproduced below to enable the cost auditor;

a) To obtain written representation from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the cost statements and for the completeness of the information provided to the cost auditor;

b) To support other evidence relevant to the cost statements or specific assertions in the cost statements by means of written representation if determined necessary by the cost auditor or required by other standard on Cost Auditing; and

c) To respond appropriately to written representation provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance in an audit of cost statements, cost records and other related information's.

Para	Relevant Requirement
5.1	***The cost auditor shall request written representations from management with appropriate responsibilities for the cost statements and knowledge of the matters concerned***
5.2	***The cost auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the cost statements in accordance with the applicable cost reporting framework, including, where relevant, their true and fair presentation, as set out in the terms of the cost audit engagement.***

Para	Relevant Requirement
5.3	***The cost auditor shall request management to provide a written representation that:*** ***1. It has provided the cost auditor with all relevant information and access as agreed in the terms of the cost audit engagement; and*** ***2. All transactions have been recorded and are reflected in the cost statements.***
5.4	***Management's responsibilities shall be described in the written representations required by paragraphs 5.2 and 5.3 in the manner in which these responsibilities are described in the terms of the cost audit engagement.***
5.5	***Other Standards on Cost Auditing require the cost auditor to request written representations. If, in addition to such required representation, the cost auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the cost statements or one or more specific assertions in the cost statements, the cost auditor shall request such other written representations.***
5.7	***The written representations shall be in the form of a representation letter addressed to the cost auditor. If the law or regulation requires management to make written public statements about its responsibilities, and the cost auditor determines that such statements provide some or all of the representations required by paragraphs 5.2 or 5.3, the relevant matters covered by such statements need not be included in the representation letter.***
5.8	***If the cost auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the cost auditor shall determine the effect of such concern may have on reliability of representations (oral or written) and audit evidence in general.***
5.9	***In particular, if written representations are inconsistent with other audit evidence, the cost auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the cost auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these and shall determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general.***

Para	Relevant Requirement
5.10	***If the cost auditor concludes that the written representations are not reliable, the cost auditor shall take appropriate actions, including determining the possible effect on the opinion in the cost auditor's report, having regard to the requirement in paragraph 5.12.***
5.11	***If management does not provide one or more of the requested written representations, the cost auditor shall:*** ***(a) Discuss the matter with management;*** ***(b) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and*** ***(c) Take appropriate actions, including determining the possible effect on the opinion in the cost auditor's report, having regard to the requirement in paragraph 5.12.***
5.12	***The cost auditor shall disclaim an opinion on the cost statements if;*** ***(a) The cost auditor concludes that there is sufficient doubt about the integrity of management such that the written representations required by paragraphs 5.2 and 5.3 are not reliable; or*** ***(b) Management does not provide the written representations required by paragraphs 5.2 and 5.3.***

The cost auditor may consider it necessary to request other written representations about the cost statements, which includes representations about the following;

- Whether the selection and application of cost accounting policies are appropriate;
- Whether matters such as the following, where relevant under the applicable cost reporting framework, have been recognized, measured, presented or disclosed in accordance with that framework
  - ✓ Plan or intentions that may affect the valuation of inventory and capacity of plant;
  - ✓ The abnormal cost and prior period items of cost have been excluded from the cost accounting records for the period;
  - ✓ The measurement, classification, allocations & apportionment of expenses to various products, activities, services, cost centre, departments, processes, etc. are properly made on the appropriate basis including estimates wherever necessary;

- ✓ The basis adopted for such measurement, allocations and apportionment have been followed consistently with due modifications wherever necessary;
- ✓ Inventory valuation is done in conformity with the cost accounting principles; and
- ✓ Aspects of law, regulations and contractual agreements for leasing of facilities and job works that may affect the cost statements, including non-compliance.

When obtaining evidence about, or evaluating, judgements and intentions, the cost auditor may consider one or more of the following;

- The entity's past history in carrying out its stated intentions;
- The entity's reasons for choosing a particular course of action;
- The entity's ability to pursue a specific course of action; and
- The existence or lack of any other information that might have been obtained during the course of the cost audit that may be inconsistent with management's judgement or intent.

9.6.2 Forms of Written Representation

Written representations are required to be included in a representation letter addressed to the cost auditor. In some jurisdictions, however, management may be required by law or regulation to make a written public statement about its responsibilities. Although such statement is a representation to the users of the cost statements, or to relevant regulatory or other authorities, the cost auditor may determine that it is an appropriate form of written representation in respect of some or all of the representations required by SCAs. Consequently, the relevant matters covered by such statement need not be included in the representation letter. Factors that may affect the cost auditor's determination include:

- Whether the statement includes confirmation of the fulfilment of the responsibilities.
- Whether the statement has been given or approved by those from whom the cost auditor requests the relevant written representations.
- Whether a copy of the statement is provided to the cost auditor as near as practicable to, but not after, the date of the cost auditor's report on the cost statements.

A formal statement of compliance with law or regulation, or of approval of the cost statements, would not contain sufficient information for the cost auditor to be satisfied that all necessary representations have been consciously made. The expression of management's responsibilities in law or regulation is also not a substitute for the requested written representations.

Appendix - IX provides an illustrative example of a representation letter.

9.6.3 Doubt About the Representations Provided or Not Provided

If there are doubts as the reliability of written representation, or requested written representations have not been provided, the cost auditor considers the nature of the concern and act accordingly.

Doubt	Cost Auditor's Response
Requested Representations Not Provided	▪ Discuss the matter with management; ▪ Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and ▪ Take appropriate actions, including determining the possible effect on the opinion in the cost auditor's report.
Inconsistencies Identified	▪ Perform additional audit procedures to attempt to resolve the matters. ▪ If the matter remain unresolved, reconsider the assessment of the competence, integrity, ethical value, or diligence of management, or of its commitment to or enforcement of these, and determine the effect that this may have on the reliability of representations (oral or written) and audit evidence as general.
Management Incompetence; **Lack of Integrity or Ethical Value**	Determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general. The cost auditor would claim an opinion on cost statements where; ▪ The cost auditor concludes that there is sufficient doubt about the integrity of management such that the required written representations are not reliable; ▪ Management does not provide the written representations required.

The cost auditor if has concerns about the competence, integrity, honesty, ethical values or diligence of management, or about its commitment to or enforcement of these, the cost auditor might conclude that the risk of management misrepresentation in the cost statements is such that a cost audit cannot be conducted. In such a case, the cost auditor may consider withdrawing from the engagement, where withdrawal is possible under applicable law or regulation, unless those charged with governance put in place appropriate corrective measures. Such measures, however, may not be sufficient to enable the cost auditor to issue an unqualified cost audit opinion.

9.6.4 Written Representation About Management's Responsibility

If the cost auditor concludes that the written representations about these matters are unreliable, or if management does not provide those written representations, the cost auditor is unable to obtain sufficient appropriate cost audit evidence. The possible effects on the cost statements of such inability are not confined to specific elements, items of cost and the cost statements and are hence pervasive. The cost auditor should disclaim or qualify an opinion on the cost statements in such circumstances.

A written representation that has been modified from that requested by the cost auditor does not necessarily mean that management did not provide the written representation. However, the underlying reason for such modification may affect the opinion in the cost auditor's report.

For example: The written representation about management's fulfilment of its responsibility for the preparation of the cost statements may state that management believes that, except for material non-compliance with a particular requirement of the applicable cost reporting framework, the cost statements are prepared in accordance with that framework. So the requirement of written representation does not apply because the cost auditor concluded that management has provided reliable written representations. However, the cost auditor is required to consider the effect of the non-compliance on the opinion in the cost auditor's report.

The written representation about the responsibility of management is to provide the cost auditor with all relevant information agreed in the terms of the cost audit engagement.It may, for example, state that management believes that, except for information destroyed in a fire, it has provided the cost auditor with such information. The requirement of management responsibilities are fulfilled because the cost auditor concluded that management has provided reliable written representations. However, the cost auditor is required to consider the effects of the pervasiveness of the information by supernatural activity like information destroyed in the fire on the cost statements and the effect thereof on the opinion in the cost auditor's report.

9.7 DOCUMENTATION

Documentary evidence is more reliable than oral evidence. Thus, management's representations should be obtained in a written form. This also reduces the possibility of misunderstandings between the engagement team and management.

The basic elements of the management representation letter are:

- It should be addressed to the auditor.
- It is dated the same date or prior to the auditor's report.
- It is normally signed by members of management who have responsibility for the entity and financial aspects (normally the directors), based on the best of their knowledge and belief.

If management refuses to provide a representation then this constitutes a limitation in scope.A consideration should be given to expressing a qualified opinion or a disclaimer of opinion.

The cost auditor has to document significant matters arising during the cost audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. The cost auditor may have identified significant issues relating to the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, but concluded that the written representations are nevertheless reliable. In such a case, all the significant matters should be documented.

The achievements of organization are the results of the combined effort of each individual.

By Vincent Lombardi

CHAPTER – 10 MATERIALITY AND AUDIT RISK

Materiality addresses the significance of cost statement information to economic decisions made by users on the basis of the cost statements. The concept of materiality recognizes that some matters, either individually or in the aggregate, are important to people making an economic decision based on the cost statements. This could include decisions such as whether to make or buy or outsourcing, productivity level, subsidies or grants, pricing policy, do business with, or enchantment of capacity of an entity.

Materiality is not an absolute number. It represents a grey area between what is very likely not material and what is very likely material. Consequently, the assessment of what is material is always a matter of professional judgment. In some situations, a matter well below the quantitative materiality level may be determined as material based on the nature of the item or the circumstances related to the misstatement. For example, the information that there are a number of transactions with related parties (i.e. more than 50% of goods produced consumed within the group entities) may be very significant to a person making a decision based on the cost statements. Finally, a series of immaterial items may well become material when aggregated together.

The arrival at a materiality level for the cost statements as a whole is, again, dependent on the cost auditor's professional judgement. However, over the years there has been a customary practice to apply percentages to certain areas of the cost statements and use those in arriving at a cost statement materiality level. For example:

- 1⁄2 to 1% of turnover / BOM cost
- 1 to 2% of gross assets (balance sheet total))
- I to 2% of Cost of production/ Cost of Goods sold before tax
- 2 to 3% of gross or net contribution

The use of percentage amounts in arriving at a cost statement materiality level is not prescriptive and the benchmarks above are given as a guideline only. Alternative methods of calculating cost statement materiality may well be more appropriate as no two audits will be the same. Depending on the levels of risk, the cost auditor may determine that the above calculations give too high materiality level and will therefore either reduce the percentages accordingly (depending on their past experience and risk assessment) or may apply a completely different way of arriving at a cost statement materiality altogether.

10.1 CONCEPT OF PROFESSIONAL JUDGEMENT

Cost Auditor is required to decide about many things while conducting an audit or assurance engagement. To decide appropriately,the cost auditor is required to apply professional judgement to the matter under consideration. Professional judgement is a skill that cost auditor acquires overtime and only after acquiring such skill, cost auditor can apply professional judgement. Cost Auditor acquired this skill by obtaining relevant;

- Training
- Skills; and
- Experience

The professional judgement is very essential to the proper audit of a cost statement. This is because interpretation of relevant ethical requirements and the requirements to comply with the principles enshrined in the Standards on Cost Auditing and the informed decisions required throughout the cost audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances.

Important Definition

Professional Judgment: The application of relevant training, knowledge and experience, within the context provided by cost auditing standards, cost accounting standards and ethical requirements, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

Professional Judgement is necessary in particular regarding decision about:

- Materiality and audit risk;
- The nature, timing, and extent of audit procedures used to meet the requirements of the SCAs and gather audit evidence;
- Evaluating whether sufficient appropriate audit evidence has been obtained and whether more needs to be done to achieve the overall objectives of cost auditor(s);
- The evaluation of management's judgements in applying the entity's applicable cost reporting framework; and
- The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the cost estimates made by management in preparing the cost statements as whole.

However, professional judgement does not mean that cost auditor can reach or form conclusion on his own. Cost auditor always make conclusion based on facts which are known to the cost auditor. Thus, it also means that professional judgement does not mean that cost auditor is capable of discovering such events and misstatements in respects of which cost auditor was unable to obtain information after applying reasonable audit procedures. Professional judgement also does not mean that auditor posses the knowledge of unknown.

10.2 MATERIALITY AND AUDIT RISK

According to **SCA 108,** "*A matter is material if its omission or misstatement would reasonably influence the economic decisions of users taken on the basis of the cost statements.*"

There is an inverse relationship between materiality and the level of audit risk, that is, the higher the materiality level, the lower the audit risk and vice versa. This should be taken into account when determining the nature, timing, and extent of audit procedures. If after planning for specific audit procedures, it is determined that the acceptable materiality is lower and the audit risk is increased, the engagement team would compensate for this by either:

- Reducing the assessed risk of material misstatement, where this is possible, and supporting the reduced level by carrying out extended or additional tests of control; or
- Reducing detection risk by modifying the nature, timing and extent of planned substantive procedures.

10.2.1 Audit Risk

Audit Risk is the risk of expressing an inappropriate audit opinion on cost statements that are materially misstated. The objective of audit is to reduce this risk to an acceptably low level. The cost auditors may certify that the cost statements give a true and fair view when they actually do not exists in letter and spirit. In other words, the cost statements contain a significant error or misstatement which the cost auditor(s) have failed to detect.

Audit Risk = Inherent Risk x Control Risk x Detection Risk

Audit risk is a function of the risk of material misstatement and detection risk.The risk of material misstatement has two components viz. Inherent Risk and Control risk.

- Inherent Risk is the risk of a material misstatement in the cost statements arising due to error or omission as a result of factors other than the failure of internal controls, such as
  - Totalling mistake
  - Mistake to correctly carry the opening balances
  - Failure to account for all expenses relating to the year
  - Wrong assessment of capacity
- Control Risk is the risk of a material misstatement in the cost statements arising due to absence or failure in the operation of relevant internal controls of the entity, such as
  - Failure to perform supervisory or authentication checks

  - – Failure to verify the veracity & accuracy of information
  - – Failure to control frauds [fake staff bills, fake production, fake sales, fake consumption,

- – Detection Risk is the risk that the auditors fail to detect a material misstatement in the cost statements.

Materiality and audit risk are considered throughout the audit in:

- ❖ Identifying and assessing the risks of material misstatement;
- ❖ Determining the nature, timing, and extent of further audit procedures;
- ❖ Determining revisions to materiality (overall and performance) after becoming aware of new information during the audit, which would have caused the auditor to have determined a different amount (or amounts) initially; and
- ❖ Evaluating the effect of uncorrected misstatements, if any, on the cost statements and in forming the opinion in the cost auditor's report.

10.3 MATERIALITY IN CONTEXT OF AUDIT OF COST STATEMENTS

SCA-108, enumerates the concept of materiality and its determination and application in context of cost audit. This is summarized below:

1) Cost reporting frameworks are generally based on the concept of materiality in the preparation and presentation of cost statements. In this context, materiality generally explains that:

    - ❖ Misstatements, including omissions, are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the decisions taken on the basis of the cost statements;
    - ❖ Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
    - ❖ Judgments about matters that are material to users of the cost statements are based on a consideration of the common cost information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

2) The cost auditor's determination of materiality is a matter of professional judgment, and is affected by the cost auditor's perception of the cost information needs of users of the cost statements. In this context, it is reasonable for the cost auditor to assume that users:

- ❖ Have a reasonable knowledge of business and economic activities and willingness to conduct the audit of cost statements with reasonable diligence.
- ❖ Recognize the uncertainties inherent in the measurement of cost based on the use of estimates, judgement, and consideration of event taken place.
- ❖ Make reasonable decisions on the basis of the information gathered and available.
- ❖ Use of benchmark in determining materiality for cost statements as a whole.
- ❖ Revision of materiality level as the cost audit progresses.

3) The concept of materiality is applied by the cost auditor both in planning and performing the cost audit, and evaluating the effect of identified misstatement and in forming the opinion in the cost auditor's report.

10.3.1 Performance Materiality

Performance materiality is the level or amounts set by the cost auditor at less than materiality for the cost statements as whole or particular items of cost to reduce the audit risk to an appropriately low level, with the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the cost statements as a whole. If applicable, performance materiality also refers to the materiality level(s) set by the cost auditor at less than the materiality level or levels for particular items of cost, cost heads, or disclosures.

Important Definition

Performance Materiality: means materiality level or levels set by the cost auditor for the cost statements as a whole or for particular items of cost, to reduce the audit risk.

During the planning process, the cost auditors will review the information they have obtained about the entity's operational results for the period and make a preliminary estimate of materiality for the cost statements as a whole. They will also look at particular item of cost, for example BOM Cost, Production Overheads, etc. and make an estimate of what they would consider to be a material misstatement for that item of cost. However, during the actual audit work, the cost auditors will set performance materiality at a lower level of materiality than they had during the planning stage, i.e. smaller items now become material. The levels of planned materiality and performance materiality should be constantly reviewed during the audit and revised as appropriate.

Setting an appropriate amount for performance materiality involves the exercise of professional judgment, and is not a simple mechanical calculation such as a percentage (e.g. 75%) of the overall materiality level. However, based on the particular circumstances of the entity being audited, it could be set as a single amount for the cost statements as a whole, or at individual amounts for items of cost, cost heads, particular balances, transactions, and disclosures.

The determination of performance materiality involves the exercise of professional judgment based on factors that address audit risk, such as the following:

- Understanding of the entity and the results of performing risk assessment procedures;
- Nature and extent of misstatements identified in previous audits; and,
- Expectations of possible misstatements in the current period.

10.3.2 Specific Materiality

There are some situations where misstatements of lesser amounts than materiality for the cost statements as a whole could reasonably be expected to influence the economic decisions of users, taken on the basis of the cost statements.

Decision Influencer	Possible Example
Laws, Regulations,and Cost AccountingFrameworkRequirements	• Sensitive cost statements disclosure such as land acquisition cost in construction industry, trail run income from new operating plant. • Related-party transactions. • Non-compliance with contractual agreements, regulatory provisions, and statutory/regulatory reporting requirements. • Certain types of expenditures such as ghost employee or executives' expenses.
Key IndustryDisclosures	• Reserves and exploration costs for a mining entity. • Research and development costs for a pharmaceutical entity. • Survey and Drilling cost in petroleum industry, • Generation cost in power generation industry.

Disclosure ofSignificant Eventsand ImportantChanges inOperations	• Newly acquired businesses or expansion of operations. • Discontinued operations. • Unusual events or contingencies (e.g., Shut down, layoff). • Introduction of new products and services.

SCA-108, also deals with the cost auditor's responsibility to apply the concept of materiality in planning and performing audit of cost statements, cost records and other related documents

This standard explains how materiality is applied in evaluating the effect of identified misstatement on the cost audit and of uncorrected misstatement, if any, on the cost statements, cost records and other related documents.

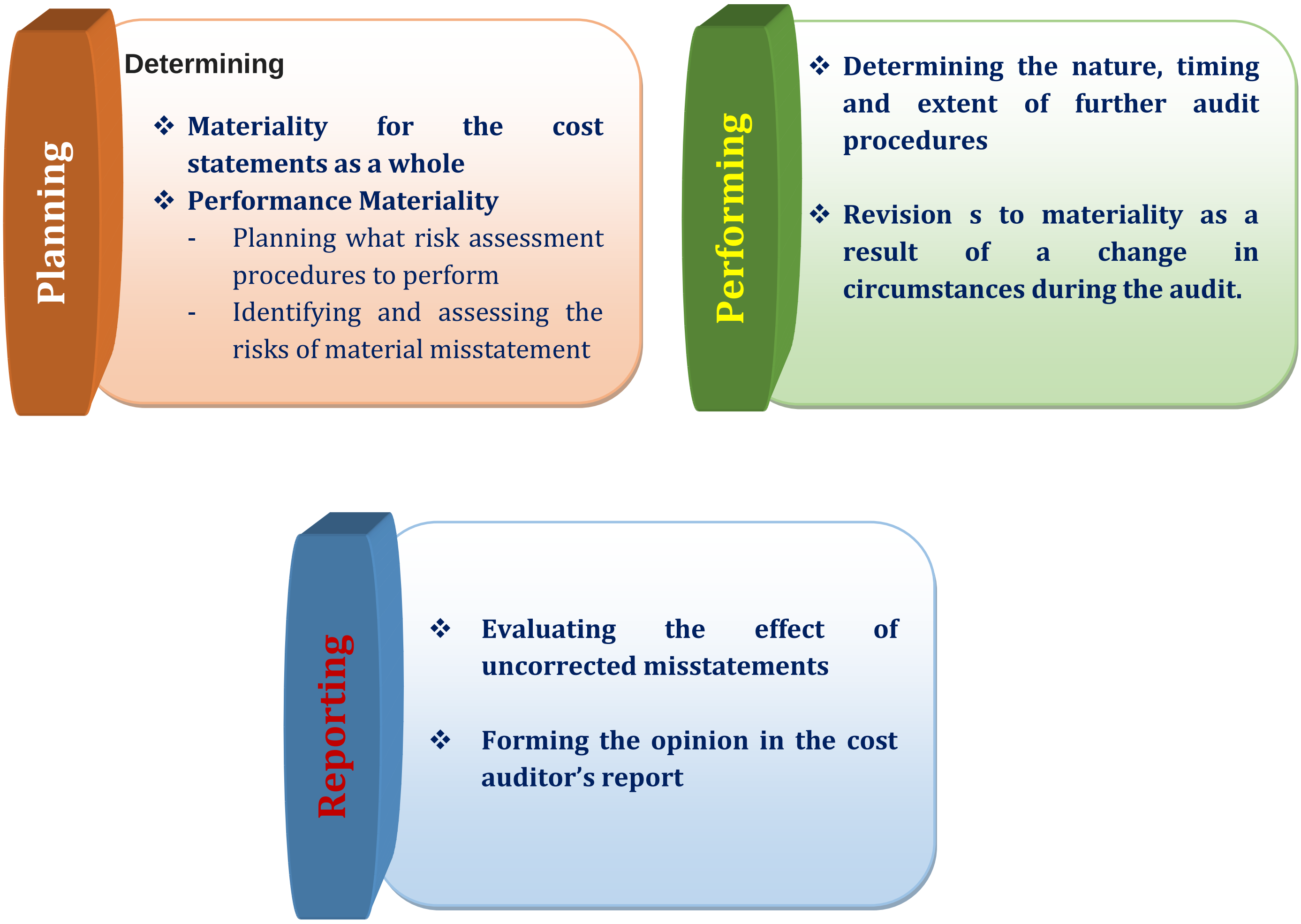
Relevant Requirements of SCA-108 ***"Materiality in Planning and Performing a Cost Audit"*** *is to enable the cost auditor to apply the concept of materiality in planning and performing the cost audit*

Para no	*Relevant Requirement*
5.1	***While establishing the overall audit strategy, the cost auditor shall determine materiality level for the cost statements as a whole that is appropriate depending on the nature of industry, scale of operations and the regulatory requirements***
5.2	***The cost auditor shall evaluate whether for one or more items of cost, there is substantial likelihood that misstatements of lesser than the materiality level established for the cost statements as a whole may influence the decision of users, the cost auditor shall also establish separate materiality level or levels for those particular items of cost.***
5.3	***The cost auditor shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further cost audit procedures.***
5.4	***The cost auditor shall revise the established materiality level or levels for the cost statements as a whole (and, if applicable, the materiality level or levels for particular items of cost) in the event of becoming aware during the audit that would have caused the cost auditor to have determined different level or levels initially.***

5.5	***If the cost auditor concludes that a lower materiality for the cost statements as a whole (and, if applicable, materiality level or levels for items of cost) than initially determined is appropriate, the cost auditor shall determine:*** ***(a) whether it is necessary to revise performance materiality, and;*** ***(b) whether the nature, timing and extent of the further cost audit procedures remain appropriate***

10.3.3 Use of Materiality in the Audit of Cost Statements

The concept of materiality is applied by the cost auditor both in planning and performing the cost audit, and in evaluating the effect of identified misstatements on the cost statements and in forming the opinion in the cost auditor's report.



10.4 HOW TO DETERMINE THE MATERIALITY

10.4.1 Overall Materiality (Cost Statement level)

Overall materiality is based on the cost auditor's perceptions of the needs of cost statement users. Cost auditors can assume the following about cost statement users.

Assumptions	
Cost Statement Users	❖ Have a reasonable knowledge of business and economic activities and cost accounting, accounting and auditing; ❖ Have a willingness to study the information in the cost statements with reasonable diligence; ❖ Understand that cost statements are prepared, presented, and audited to levels of materiality; ❖ Recognize the uncertainties inherent in the measurement of amounts based on the use of cost estimates, judgment, and the consideration of future events; and ❖ Make reasonable economic decisions on the basis of the information in the cost statements.

A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the cost statements as a whole. Factors that may affect the identification of an appropriate benchmark include:

a) The elements of the cost statement (for example, capacity, nature of products or services, cost of production or operation, cost of sales);

b) Whether there are items on which the attention of the users of the particular entity's cost statements tends to be focused (for example for the purpose of evaluating cost statements users may tend to focus on valuation of material cost, utilities cost, primary packing material cost, apportionment of overheads);

c) The nature of the entity, where the entity is in its life cycle, and the industry and regulatory or non-regulatory sector in which the entity operates;

d) The entity's production or operational structure, production facilities, production units or locations of its operation (for example, an entity is a manufacturing a single product on multi locations or manufacturing multi products on a single location, number of shifts, number of cities or locations of rendering services); and

e) The relative volatility of the benchmark.

Example of benchmarks that may be appropriate, depending on the circumstances of the entity, include types of cost such as materials cost, utilities cost, cost of production or operation, cost of goods sold. Materials cost or cost of production benchmark is often used by heavy industries. When benchmarks percentage from continuing operation is volatile, other benchmarks may be more appropriate, such as cost of goods sold.

In relation to chosen benchmark, relevant data ordinarily include previous year's cost records, cost statement, cost reporting framework, the period-to-date cost information, and budgets or forecast for the current period, adjusted for significant changes in the circumstances of the entity (for example a significant change in production process or operating process) and the relevant changes of condition in the industry, market, economic environment in which entity operates. For example, when as a starting point, materiality for the cost statements as a whole is determined for a particular entity based on percentage of cost of production from continuing operations, circumstances that gives rise to an exceptional changes in such percentage may lead the cost auditor to conclude that materiality for the cost statements as a whole is more appropriately determined using cost of goods sold after absorption of overheads from continuing operations based on past year's performance.

There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to cost of production from continuing operations will normally be higher than a percentage applied to cost of goods sold. For example, the cost auditor may consider fifty percent of mark up of cost of production from continuing operations to be appropriate for a manufacturing industry, while the cost auditor may consider seventy five percent of cost of goods sold or total expenses to be appropriate for a service industry. Higher or lower percentages, however, may be deemed as appropriate in the circumstances.

10.4.2 Performance Materiality

Whereas overall and specific materiality is set in relation to the needs of cost statement users, performance materiality is set at a lower amount. This will result in more audit work being performed (smaller misstatements may be identified) and audit risk being reduced to an appropriately low level.

If the audit was planned solely to detect individually material misstatements, there would be no margin of error to identify and account for immaterial misstatements that might exist. As a result, it could be possible for the aggregate of individually immaterial misstatements to cause the cost statements to be materially misstated.

Performance materiality is designed to:

- Ensure that immaterial misstatements less than overall or specific materiality are detected, and
- Provide a margin or buffer for possible undetected misstatements. This buffer is between detected but uncorrected misstatements in the aggregate and the overall or specific materiality.

The determination of performance materiality would not be a simple mechanical calculation such as 80% of overall materiality. This simplification would ignore specific risk factors that may be relevant to the entity. For example, if there was a high risk of errors in apportionment of common cost, performance materiality could be lowered so that additional work is performed to identify the extent of misstatements. Conversely, if the risk of misstatement in the treatment of revenue is assessed as low, the performance materiality could be raised, resulting in less substantive audit work on the balance.

Performance materiality requires the auditor to exercise professional judgment and is affected by:

- The cost auditor's understanding of the entity, which is updated during the execution of the risk assessment procedures; and
- The nature and extent of misstatements identified in previous audits.

Summary of Concept of Materiality

Issue	***Overall***	***Specific***	***Performance***
Purpose	To establish the threshold for determining whether the cost statements are free from material misstatement, whether due to error or fraud.	To establish a threshold(s) (lower than overall materiality) to be applied to particular items of cost, cost heads classes of transactions, account balances, or disclosures where misstatements of lesser amounts than overall materiality for the financial statements could reasonably be expected to influence the economic decisions of users.	To establish the threshold(s) (lower than overall or specific materiality) that ensures immaterial misstatements (less than overall or specific materiality) are identified, and provide the cost auditor with a safety margin.
Basis of calculation	What level of misstatement in the cost statements would be tolerable to users (i.e., would not affect the economic decisions made by a cost statement user)?	What level of misstatement relating to special circumstances in a particular class of transactions, account balances, or disclosures could reasonably be expected to influence the economic decisions of users?	What amount of audit work will be required to: • Identify misstatements below overall or specific materiality; and • Leave a sufficient buffer for undetected misstatements?
Rule of thumb	Materiality is a matter of professional judgment	Establish a lower, specific materiality amount (based	No specific guidance is provided in the ISAs.

Issue	*Overall*	*Specific*	*Performance*
(starting point)	rather than a mechanical exercise. Asa result, no specific guidance isprovided in the SCAs. However, operating profit from continuing operations (3 to 7%) is often used in practice as having the greatest significance to cost statement users. If this is not a useful measure (such as for a not-for-profit entity or where profit is not a stable base), then consider other bases such as: - *Revenues or expenditures 1 to 3%* - *Assets 1 to 3%; or1/2 to 1% of turnover / BOM cost* - *1 to 2% of gross assets (balance sheet total))* - *I to 2% of Cost of production/ Cost of Goods sold before tax* - *2 to 3% of gross or net contribution.*	on professional judgment) for the audit of specific or sensitive cost statement areas.	Percentages range from 60% (of overall or specific materiality), where there is a higher risk of material misstatement, up to 85%, where the assessed risk of material misstatement is less.
Use in cost audit	Determining whether uncorrected misstatements, individually or in aggregate, exceed **overall** materiality.	Determining whether uncorrected misstatements, individually or in aggregate,exceed the **specific** materiality.	Assessing the risks of material misstatement; and designing further audit procedures to respond to assessed risks.
Revision as Audit Progress	A change in circumstances thatoccurred during the audit such as the sale of part of the business; • New information; or • A change in the cost	A change in the special circumstances.	Changes in assessed risks; • Nature and extent of misstatements found when performing further audit procedures; or • Change in understanding

Issue	Overall	Specific	Performance
	auditor'sunderstanding of the entity and its operations, as a result of performing further audit procedures (e.g., actual operatingresults being very different from expected).		of theentity.

10.5 USE OF MATERIALITY IN VARIOUS STAGE OF AUDIT OF COST STATEMENTS

Materiality levels are a key component of audit of cost statements. The materiality can be determined phase wise and revised as the audit progress. The use of materiality in different phases is outlined below:

a) Materiality in Planning and Risk Assessment
b) Materiality in Performing Audit Procedures
c) Materiality in Reporting

10.5.1 Materiality in Planning and Risk Assessment

Determining the various materiality levels is a key component of the planning process. This is not a discrete phase of an audit, but rather a continual and iterative process. The following table summarizes the use of materiality in planning and risk assessment.

	Materiality
Planning*(Overall Strategyand Audit Plans)*	Use materiality to: ♦ Determine what cost statement areas require auditing. ♦ Set the context for the overall audit strategy. ♦ Plan the nature, timing, and extent of specific audit procedures. ♦ Determine specific materiality for particular item of costs, cost heads, classes of transactions, account balances, or disclosures where misstatements at lesser amounts than overall or performance materiality could reasonably be expected to influence the economic decisions of users. ♦ Determine performance materiality for each specific materiality level, as it may be necessary for the cost auditor to work using a performance materiality level for a particular item of cost, cost heads, class of transactions,

	Materiality
	account balance, or disclosure, depending on the level of risk associated with that item. ♦ Evaluate later evidence to determine the need for any adjustment to any of the materiality levels. If so, the cost auditor would revise the nature, timing, and extent of procedures accordingly.
Risk AssessmentProcedures	♦ Identify what risk assessment procedures are necessary. ♦ Provide a context when evaluating the information obtained. ♦ Assess the magnitude (impact) of the risks identified. ♦ Assess results of risk assessment procedures.
Team Meetings	♦ Ensure that team members understand the identified users and what could reasonably be expected to change their economic decisions. This may help in the event that a team member becomes aware of information during the audit that would have caused a different amount of materiality to be determined initially. **Examples of such matters include:** ❖ A decision to dispose of a major part of the entity's business, ❖ New information or risk factors that would have affected the initial determination of materiality, and ❖ A change in the cost auditor's understanding of the entity and its operations as a result of performing further audit procedures, such as when actual financial results are substantially different from anticipated results. ♦ Establish overall audit strategy. ♦ Determine the extent of testing in relation to: ❖ Performance materiality, and ❖ Specific performance materiality ♦ Identify critical audit issues and areas for significant audit focus.

10.5.2 Materiality in Performing Audit Procedures

Cost auditors should consider materiality when determining the nature, timing, and extent of audit procedures, as illustrated in the following table.

	Materiality
Performing Audit Procedure	Use materiality to: ♦ Identify what further audit procedures are necessary. ♦ Determine which items to select for testing and whether to use sampling techniques. ♦ Assist with determining sample sizes **(e.g., sampling interval = precision (materiality)÷ confidence factor)**. ♦ Evaluate representative sampling errors by extrapolating across population for "likely" misstatements. ♦ Evaluate the aggregate of total errors at the general ledger level up to the cost statement level. ♦ Evaluate the aggregate of total errors, including the net effect of uncorrected misstatements in opening costing profit & loss account. ♦ Assess results of procedures.

Note:

1) The overall audit strategy and audit plan will need to be revised where:

- The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or

- The aggregate of misstatements accumulated during the audit approaches materiality.

2) Overall materiality is unlikely to change very often. However, it may need to be revised as the cost auditor becomes aware of new information or if there is a change in the cost auditor's understanding of the entity and its operations. If a change is required, ensure that the audit team is informed and assesses the impact on the audit plan.

3) Performance materiality may change based on new risk factors or new audit findings that may not impact overall materiality. Changes in performance materiality will result in the modification of the nature, timing, and extent of audit procedures. Of course, if overall materiality changes, a corresponding change will likely be required in performance materiality.

10.5.3 Materiality in Reporting

Prior to issuing an opinion, the cost auditor would

- Confirm the materiality established for the cost statements as a whole;
- Evaluate the nature and the aggregate of uncorrected misstatements that are identified; and
- Make an overall assessment as to whether the cost statements are materially misstated.
-

	Materiality
Reporting	Use materiality to: • Evaluate the aggregate of total errors at the general ledger level up to the cost statement level. • Evaluate the aggregate of total errors, including the net effect of uncorrected misstatements in opening costing profit and loss account. • Determine whether additional audit procedures should be performed when the aggregate misstatements are approaching overall or specific materiality. • Request that management correct all identified misstatements. • Consider rechecking areas of highest misstatement. • Make judgments about the nature and sensitivity of the misstatements identified, as well as their size. • Determine whether the cost auditor's report needs to be modified due to uncorrected material misstatements.

10.6 OTHER CONSIDERATIONS

Other considerations include:

- Communicating to management and those charged with governance;
- Updating materiality; and
- Reducing materiality level from previous period

10.6.1 Communicating to Management and Those Charged with Governance

Management and those charged with governance need to understand the limitations concerning the degree of precision that can be expected from an audit of cost statements. They also need to be aware that it is not economically feasible to design audit procedures that will provide absolute assurance that the cost statements are not materially misstated. An audit of cost statement can provide only reasonable assurance in this regard.

10.6.2 Updating Materiality

The preliminary assessment of overall and performance materiality may change from the initial audit planning to the time of evaluating the results of the audit procedures. This could result from a change in circumstances or from a change in the cost auditor's knowledge as a result of performing audit procedures. For example, if audit procedures are performed prior to the period end, the cost auditor will anticipate the results of operations, key ratios and the financial position. If the actual results of operations, key ratios and financial position are substantially different, the assessments of materiality and audit risk may also change.

10.6.3 Reducing Materiality Level from Previous Period

When circumstances change from one period to the next, the cost auditor should consider the effect of any misstatement on the opening costing profit and loss account. For example, where sales and contribution are substantially less than the previous period's, a lower materiality is required. Errors could exist in opening figures, as the cost audit was previously conducted using a higher materiality level.

Important Point

New engagements

When accepting a new audit engagement, inquire about the overall materiality used by the previous cost auditor. If available, this would help in determining whether further audit procedures may be required on the opening inventory balances.

Use of management experts

Ensure that any experts employed by the entity (to assist the entity in preparing the cost statements) or used by the audit team are instructed to use an appropriate materiality level in relationto the work they perform.

10.7 DOCUMENTATION

Document the determination of the following and the factors considered in their determination:

- Overall materiality;
- Where applicable, the specific materiality level(s) for particular item of cost, cost heads, consumption levels, fixed & variable costs, or disclosures;
- Performance materiality; and
- Any revision of the above factors as the audit progresses.

CHAPTER -11 AUDIT SAMPLING

A cost auditor will not be able to test 100% of the transactions within a set of cost statements as this will be far too costly and impracticable. Instead, he will use a technique known as 'audit sampling'.

Audit sampling is the use of audit procedures to less than 100% of an item of costs, cost heads, consumption levels, or class of transactions. Its overall objective is to enable cost auditor to obtain and evaluate evidence about some of the characteristics of the items selected in order to form a conclusion about the population sampled.

Audit Sampling can use either a statistical or a non- statistical approach

11.1 RELATIONSHIP BETWEEN MATERIALITY AND AUDIT SAMPLING

There is an inverse relationship between sample size and materiality (i.e. if materiality increases then sample size decreases) and a direct relationship between sample size and the desired level of assurance (i.e. if the desired level of assurance increases then sample size increases).

A lower materiality requires the cost auditor to use a finer filter (larger sample). Small materiality requires a larger sample. As desired assurance for a given materiality amount increases, sample size increases.

Important Definitions

Anomaly: A misstatement or deviation that is demonstrably not representative of misstatement or deviations in a population.

Audit Sampling: The application of audit procedure to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the Cost Auditor a reasonable basis to draw conclusions about the entire population.

Statistical Sampling: An approach to sampling that has the following characteristics:

i) Random selection of the sample item: and

ii)The use of probability theory to evaluate sample results, including measurement of sampling risk.

iii)A Sampling approach that does not have characteristic (a) and (b) is considered non-statistical sampling.

Sampling Unit: The individual items constituting a population

The sampling unit might be physical item (for example, checks listed on material issue slip, consumption statement entries, invoices or inventory balances) or monetary units.

11.2 NEED AND IMPORTANCE OF AUDIT SAMPLING

The need for audit sampling arises from

- The increasing complexities in business,
- Cost auditor's time involved and
- The volume of transactions involved in the business

11.3 THE PURPOSE OF AUDIT SAMPLING IS

- to obtain an evidence,
- to fulfil the audit objectives set by the auditor
- which enables the auditor to test the validity and accuracy of the transactions

11.4 STEPS FOR AUDIT SAMPLING

The cost auditor shall consider the following steps in planning, selecting and performing test thereupon, and evaluating the results derived from audit sampling:

(a) Planning the audit sampling

- State the objective of audit test.
- Decide whether audit sampling applies.
- Define attributes and expectation conditions.
- Define population.
- Define sampling unit.
- Specify the tolerable expectation rate.
- Specify acceptable risk of assessing control risk.
- Estimate population expectation rate.
- Determine the initial sample size.

(b) Selecting audit sampling and performing the tests

- Select the audit sampling.
- Perform the audit procedures.

(c) Evaluating the audit sampling the results

- Generalize from the sample to population.
- Analyze exceptions.
- Decide the acceptability of the population.

11.5 METHODS OF SAMPLING

There are many methods of selecting samples, the cost auditor shall select samples on the basis of principal methods are as follow:

a) **Random Selection:** This method of sampling ensures that all items within a population stand an equal chance of selection.(applied through random number generators, for example, random number tables)

b) **Systematic Selection:** This is in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50^{th} sampling unit thereafter is selected. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerised random number generator or random number tables. When using systematic selection, the auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval correspond with a particular pattern in the population.

c) **Monetary unit sampling**: This method is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

d) **Value Weighted Selection:** When performing tests of details it may be efficient to identify the sampling unit as the individual monetary units that make up the population. Having selected specific monetary units from within the population, for example, the BOM cost balance, the cost auditor may then examine the particular items, for example, individual balances, that contain those monetary units.

   One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes. This approach may be used in conjunction with the systematic method of sample selectionand is most efficient when selecting items using random selection.

e) **Haphazard selection:** This method is in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability. i.e. 'Play-win Lottery'

   For example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

f) **Block selection:** This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection techniques when the auditor intends to draw valid inferences about the entire population based on the sample.

Relevant Requirements of SCA-106 ***"Audit Sampling"is to provide a reasonable basis for the Cost Auditor to draw conclusion about the population from which the sample is selected in performing audit procedures for the audit of cost statement, cost records and other related documents*** *are reproduced below:*

Para no.	Relevant Requirements
5.1	***The cost auditor as part of the audit sampling shall consider the purpose of the cost audit procedure and the characteristics of the population when designing the audit sampling, its sufficient size and selection of items in such a way that each sampling unit in the population shall have the chance for testing in order to reduce sampling risk to an acceptably low level.***
5.2	***The cost auditor shall perform cost audit procedure, appropriate to the purpose, on each item selected and if the cost audit procedure is not applicable to the selected item, the auditor shall perform the audit procedure on replacement items***
5.3	***If the cost auditor is unable to apply the designated cost audit procedure, or suitable alternative procedures, to a selected item, the cost auditor shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details.***
5.4	***The cost auditor shall investigate the nature and causes of any deviation or misstatement identified, and thereby evaluate their possible effect on the purpose of cost audit procedure and on other areas of audit.***
5.5	***In the extremely rare circumstances when the cost auditor considers a misstatement or deviation discovered in sample to be an anomaly, the cost auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population. The cost auditor shall obtain this high degree of certainty by performing additional audit procedure to obtain sufficient appropriate audit evidence that such misstatement or deviation shall not affect the remainder of the population.***
5.6	***The cost auditor shall project misstatements found in the sample to the population for the purpose of tests of details.***
5.7	***The cost auditor shall ensure that the use of audit sampling has provided a reasonable basis for conclusions about the population tested and thereby shall evaluate the results derived from sample tested.***

11.6 STATISTICAL SAMPLING AND NON-STATISTICAL SAMPLING

The difference between statistical and non-statistical sampling is that statistical sampling allows the user to measure the sampling risk associated with the procedure. When applying statistical sampling, the sample size can be determined using eitherprobability theory or professional judgement. Non-statistical sampling relies on one'sprofessional judgement.

Examples of non-sampling risk include use of inappropriate audit procedures, ormisinterpretation of audit evidence and failure to recognize a misstatement ordeviation.

The cost auditor shall determine the selection to use a statistical or non-statistical sampling approach on the basis of professional judgement; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches. The method of sample selection will affect not only the sample sizes used but also the method by which errors will be evaluated.

The cost auditor shall ensure when selecting statistical sampling that each items should be selected in such a way that each sampling unit shall have known probability of being selected.

The advantages of statistical sampling are:

- It imposes a more formal discipline towards planning the audit of a population.
- The required sample size is determined objectively.
- The evaluation of test results is made more precisely and the sampling risk is quantified.

The disadvantages of statistical sampling are:

- Lack of judgement *(however, note that judgement is used to set the objectives forthe sample and to evaluate the results of tests)*.
- Statistical sampling produces one sample size (which may be inappropriate).
- Statistical procedures can take time to set up and to implement. However in practice, little extra time is incurred in planning a statistical sampling approach and statistical procedures are particularly cost effective if:
  - there is a large population; and "
  - a large number of small items are being examined, rather than a small number of larger items.
- Statistical sampling procedures impact on sample sizes. It is possible that statistical sample sizes could be higher than those derived at using judgmental methods (this however, depends on the judgement of the person carrying out the test).

NOTE: if the engagement team considers that the statistical sample size derived ishigher than required, the sample size can be reduced based on the engagement team'sprofessional judgement, and provided that reasons for doing so are fully justified anddocumented.

11.7 FACTOR TO BE CONSIDERED IN USE OF SAMPLING TECHNIQUES

Whenever statistical or non-statistical sampling techniques are being considered, the cost auditor would address and document the following matters.

Factor to Consider	Comments
Purpose of Test	The starting point for the test design is to establish the purpose of the test and whatassertions will be addressed?
Primary Source ofEvidence	What is the primary source of evidence for each assertion to be addressed, and whatis secondary? This differentiation will help to ensure that audit effort is directed to theright place.
PreviousExperience	What was the experience (if any) in performing similar tests in previous periods? Consider the effectiveness of the test, and the existence and disposition of deviations(errors), if any, found in the samples selected.
What Population	Ensure that the population of items to be tested is appropriate to achieve the testobjectives. Sampling will not identify or test items that are not already includedwithin the population. For example, a sample of Production & Operation Overheads balances may be used totest the overhead ratefor cost unit, but such a population would not be appropriate fortesting the completeness of overhead rate. Also consider the size of the population. In some cases, a statistical conclusion maynot be drawn if the population to be tested is too small to sample.
What SamplingUnit to Use	Consider the purpose of the test and the assertion being addressed. This decision willdetermine what items will be selected to test.

Factor to Consider	Comments
Statistical or Non-Statistical	Statistical conclusions can be drawn from statistical samples. Conclusions based onprofessional judgment can be made from judgmental non-statistical samples. Non-statisticalsamples are often used in combination with other audit procedures thataddress the same assertion.
Definition of aDeviation	Failure to properly define a deviation will result in time wasted by staff in reviewingminor exceptions that may not constitute a deviation. Also, determine how thereasons and implications of deviations found will be followed up by audit team.
Any High-ValueItems to Exclude	If there are larger transactions or balances in the population that can be evaluatedseparately, it may result in smaller sample sizes from remaining items in thepopulation. In some cases, the evidence gained from testing the larger transactionsor balances may be sufficient to eliminate the need for sampling altogether.
Use of CAATs	Could computer-assisted audit techniques (CAATs) provide a better or more efficientresult? For many tests, 100% of the population can be tested by CAATs (as opposed to justa sample).
Any StratificationPossible	Consider whether the population can be stratified by dividing it into discretesubpopulations which have an identifying characteristic. For example, if a population contained a number of high-value transactions, thepopulation (for a test of details) could be stratified by monetary value. This allowsgreater audit effort to be directed to the larger-value items, as these items maycontain the greatest potential misstatement in terms of overstatement. A population may also be stratified according to a particular characteristic thatindicates a higher risk of misstatement. Where subpopulations are tested separately, the misstatements will be projectedfor

Factor to Consider	Comments
	each stratum separately. Projected misstatements for each stratum can then becombined to consider the possible effect of misstatements on the account balance orclass of transactions.
What Precision is required	Performance materiality is often used as the basis for tolerable misstatement. Thisalso represents the precision for a statistical test. Performance materiality would be set at an amount that allows for the possible existenceof undetected and immaterial misstatements aggregating to a material amount.
What Confidence level is required	Confidence is the level of acceptable risk (detection risk) that the test will not produceaccurate results. Is a high level of confidence (resulting in a larger sample) or a lowerconfidence level (resulting in a smaller sample) required? The confidence level required in a particular test will be based on factors such as: o Evidence obtained from other sources such as analytical review, othersubstantive procedures, and testing the operational effectiveness of relatedcontrols; and o The importance of the cost statement assertion or line item compared withoverall materiality. For example, a 95% level of confidence indicates that if a particular test wasperformed 100 times (selecting representative transactions at random), the resultswould be accurate (within the margin of misstatement) 95 times out of the 100 tests.There is a risk that 5 tests out of the 100 will produce inaccurate results.

Factor to Consider	Comments
What is theTolerableMisstatementor TolerableDeviation Rate	When statistical sampling is planned, the tolerable misstatement or deviation rate would also be addressed. Tolerable misstatement is used in sampling tests of details to address the risk thatthe aggregate of individually immaterial misstatements may cause the cost statements to be materially misstated, and to provide a margin for possibleundetected misstatements. Tolerable misstatement is the application of performancemateriality to a particular sampling procedure. Tolerable misstatement may be thesame amount as or an amount lower than performance materiality. Tolerable rate of deviation is used for tests of controls where the auditor sets a rate ofdeviation from prescribed internal control procedures to obtain an appropriate levelof assurance. The auditor seeks to obtain an appropriate level of assurance that the setrate of deviation is not exceeded by the actual rate of deviation in the population.

An Illustrative list of factors influencing Sample Size is given in Appendix - X

11.8 DESIGN OF THE SAMPLE

The following should be considered in the design of the sample

1. Audit Objectives
2. Population
3. Stratification
4. Sample Size
5. Sampling Risk

The cost auditor shall include the following consideration when designing an audit sampling:

- Specific purpose to be achieved
- Combination of audit procedure that is likely to best achieve audit purpose
- Nature of audit evidence sought
- Factors of possible deviation or misstatement conditions or other characteristics relating to audit evidence

- Circumstances relevant to the purpose of audit procedures shall also be included for the purpose of evaluation of deviation or projection of misstatement.

These considerations shall also assist cost auditor in defining what constitutes a deviation or misstatement and what population to be used for sampling.

11.8.1 Audit Objectives

When designing an audit sample, the cost auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose. Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the cost auditor in defining what constitutes a deviation or misstatement and what population to use for audit sampling.

In fulfilling the requirements of SCA 106, when performing audit sampling, the cost auditor performs audit procedures to obtain evidence that the population from which the audit sample is drawn is complete. The specific audit objectives and audit procedures to accomplish those objectives should be determined.

11.8.2 Population

The population is the entire set of data from which the auditor wishes to sample in order to reach a conclusion. The cost auditor will need to determine that the population from which the sample is drawn is appropriate for the specific audit objective.

Population: The entire set of data from which a sample is selected and about which the cost auditor wishes to draw conclusions.

(a) **Appropriate** to the objective of the audit procedures, which will include consideration of the direction of testing. For example, if the engagement team's objective is to test overstatement of BOM consumption details, the population could be defined as the consumption details, on the other hand, when testing for understatement of Overhead absorption Rate, the population is not Overhead, but subsequent production of inventory, capacity determination, method of absorption, allocation of overhead to cost centre, apportionment of overhead or other population that provide audit evidence of understatement of overheads i.e. Production details.

(b) **Complete.** For example, if one intend to select consumption details from system, conclusion cannot be drawn about all voucher for the period unless one is satisfied that all voucher have been in fact generated in system.

Audit efficiency may be further improved if the population is stratified by dividing it into discrete sub-populations which have an identifying characteristic.

A 'population' is made up of individual elements of a figure, as illustrated below:

Example

An entity produce a list of BOM Consumption as at 31st March, 20..., which shown below

BOM Consumption	Quantity	Amount (in Rupees)
Material A	10000	100000.00
Material B	5000	250000.00
Material C	15000	75000.00
Material D	50000	50000.00
Material E	2000	150000.00
Material F	800	800000.00
Total		1425000.00

These are the individual components of the population. The sampling may be done on value or quantity or both, as the case may be.

The total figure is known as "population"

11.8.3 Stratification

- Stratification is the process of dividing a population into sub-populations, each of which is a group of sampling units, which have similar characteristics.
- The strata need to be explicitly defined so that each sampling unit can belong to only one stratum. This process reduces the variability of the items within each stratum. Stratification therefore, enables the cost auditor to direct audit efforts towards the items which for example contain the greatest potential monetary error.
- For example, the cost auditor may direct attention to larger value items for consumption details to detect overstated material misstatements.

Stratification: The process of dividing a population into sub-population, each of which is a group of sampling units which have similar characteristics (often monetary value).

It is important to note that generally, stratification requires that the sample results be extrapolated to each strata separately. In other words, if a cost auditor divides the population into two groups, production of goods and rendering of services, to make both groups more homogeneous, then the results of the sample from the production group should only be extrapolated to the total production of goods and the results of the sample from the services group should only be extrapolated to the rendering of services.

Where the sample is limited to specific time periods, the cost auditor will need to confirm that the data from the entire population can be stratified before the resulting error rates can be applied.

Stratification is most often performed during computer assisted audits. Computer software applications can easily segregate a population and provide subtotals. It is advisable that cost auditors contact the Computer Assisted Audit Team when working with a high volume of transactions or with large data files. A minimum of three errors per strata is necessary for extrapolation to strata population.

The following are some method of stratification

a) By Amount
b) By Nature of the Items
c) By Nature of Test

The methods for stratifying described above may be used separately or in combination. For instance, the cost auditor may stratify first by the nature of the items, then by amount.

Example

A sells three types of manufactured computer equipment: laptops, desktops, and network servers. The cost auditor decides to stratify the total population of production by type of computer equipment, since that tends to create more homogeneous sub-populations. Since this is still a non-homogeneous stratified population, the sample size computed from the sampling size table is 100 per strata.

There were Rs.20,00,000worth of laptop production during the period, Rs. 30,00,000 worth of desktop production and Rs.50,00,000 worth of server production.

The cost auditor should allocate the total sample size as follows:

- 100 from laptop production
- 100 from Desktop production
- 100 from Network Server production

The results were as follows:

- 5% under-reported laptop production X 20,00,000 = Rs.1,00,000
- 5% over-reported desktop production X 30,00,000 = (Rs.1,50,000)
- 10% under-reported network production X 50,00,000 = Rs.5,00,000

The total exception in this case would be the sum of the separately extrapolated sample results, the net amount of Rs. 4,50,000 under reported.

11.8.4 Sample Size

- Whiledetermining the sample size the cost auditor should consider the sampling risk for determining the tolerable error and the expected error.
- Sampling size is affected by the level of sampling risk the cost auditor is willing to accept from the results of the sample. The lower the risk the cost auditor is willing to accept, the greater the sample size will need to be.
- The following factors are particularly important when setting a sample size:
  - ✓ The sampling risk
  - ✓ The tolerable error rate
  - ✓ The expected error rate
  - ✓ The population value (substantive tests of account balances only)
  - ✓ The number of items in the population (small populations only)

A detailed Guidance on the Factor influencing the sample size is provided in Appendix –X.

11.8.5 Sampling Risk

It arises from the possibility that the cost auditor's conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure.

Sampling risk will always be present if a sample is tested within a population, rather thanthe entire population being tested. The key factor is to decide the level of sampling riskto accept. This decision is influenced by the amount of reliance being placed on the test.Reliance on the test will be low if:

a. The population tested is inherently unlikely to contain errors;
b. Reliance is being placed on analytical procedures;
c. Reliance is being placed on internal controls; or
d. Reliance is being placed on other substantive procedures.

Sampling risk: The risk that the cost auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Non-sampling risk: The risk that the cost auditor reaches an erroneous conclusion for

The cost auditor is faced with sampling risk in both tests of control and substantive procedures as follows;

11.8.6 Tests of control

Risk of under reliance: the risk that although the sample result does not support the cost auditor's assessment of control risk, the actual compliance rate would support such an assessment.

Risk of over reliance: the risk that, although the sample result supports the cost auditor's assessment of control risk, the actual compliance rate would not support such an assessment.

11.8.7 Substantive procedures

Risk of incorrect rejection: the risk that although the sample result supports the conclusion that a recorded item of costs, cost heads, account balance or class of transactions is materially misstated; in fact, it is not materially misstated.

Risk of incorrect acceptance: the risk that although the sample result supports the conclusion that a recorded item of costs, cost heads, account balance or class of transactions is not materially misstated; in fact, it is materially misstated.

- The risk of audit reliance and the risk of incorrect rejection affect audit efficiency as they would ordinarily lead to additional work being performed by the auditor or the entity which would establish that the initial conclusions were incorrect.
- The risk of over reliance and the risk of incorrect acceptance affect audit effectiveness and are more likely to lead to an erroneous opinion on the cost statements than either the risk of under reliance or the risk of incorrect rejection

11.9 TOLERABLE ERROR

It is the maximum error in the population that the cost auditor would be willing to accept and still concludes that the result from the sample has achieved the audit objective. Tolerable error is considered during the planning stage and for substantive procedures is related to the cost auditor's judgment about materiality. The smaller the tolerable error the greater the sample size will need to be.

Tolerable rate of deviation: A monetary amount set by the cost auditor in respect of which the cost auditor seek to obtain an appropriate level of assurance that the monetary amount set by the cost auditor is not exceed by the actual misstatement in the population.

11.9.1 In Tests of Control, the tolerable error is the maximum rate of deviation from a prescribed control procedure that the cost auditor would be willing to accept, based on the preliminary assessment of control risk.

11.9.2 In Substantive Procedures, the tolerable error is the maximum monetary error in an item of cost, cost heads, consumption details, account balance or class of transactions that the cost auditor would be willing to accept so that when the results of all audit procedures are considered, the cost auditor is able to conclude with reasonable assurance, that the cost statements are not materially misstated.

11.10 EXPECTED ERROR

If the cost auditor expects error to be present in the population, a larger sample than when no error is expected ordinarily needs to be examined to conclude that the actual error in the population is not greater than the planned tolerable error.

Tolerable rate of deviation: A rate of deviation from prescribed internal control procedures set by the cost auditor in respect of which the cost auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

Smaller sample sizes are justified when the population is expected to be error free. In determining the expected error in a population, the cost auditor would consider such matters as error levels identified in previous audits, changes in the entity's procedures, and evidence available from other procedures.

11.11 EVALUATION OF SAMPLE RESULTS

Having carried out, on each sample item, those audit procedures that are appropriate to the particular audit objective, the cost auditor should:

- Analyze any errors detected in the sample
- Project the errors found in the sample to the population and

- ❖ Reassess the sampling risk

11.11.1 Analysis of Errors in the Sample

In deciding the sample, the cost auditor will have defined those conditions that constitute an error by reference to the audit objectives. For example, in a substantive procedure relating to the recording of variance, a wrong posting between cost heads does not affect the total variances. Therefore, it may be inappropriate to consider this an error in evaluating the sample results of this particular procedure, even though it may have an effect on other areas of the audit such as the assessment of price variance.

When the expected audit evidence regarding a specific sample item cannot be obtained, the cost auditor may be able to obtain sufficient appropriate audit evidence through performing alternative procedures. For example, if a positive third party stock confirmation has been requested and no reply was received, the cost auditor may be able to obtain sufficient appropriate audit evidence that the receivable is valid by reviewing subsequent issue and receipt from the third party. If the cost auditor does not or is unable to perform satisfactory alternative procedures or if the procedures performed do not enable the cost auditor to obtain sufficient appropriate audit evidence, the item would be treated as an error.

In analyzing the errors discovered, the cost auditor may observe that many have a common feature for example, type of transaction, location, product line, or period of item. In such circumstances, the cost auditor may decide to identify all items in the population, which possess the common feature, thereby producing a sub population and extend audit procedures in this area, the auditor would then perform a separate analysis based on the items examined for each sub population.

11.11.2 Projection of Errors

The cost auditor projects the error results of the sample to the population from which the sample was selected. These are several acceptable methods of projecting error results. However, in all the cases, the method of projection will need to be consistent with the method used to select the sampling unit. When projecting error results, the cost auditor needs to keep in mind the qualitative aspects of the errors found. When the population has been divided into sub population, the projection of errors is done separately for each sub population and the results are combined.

The cost auditor shall not necessarily explicit projection of deviation since the sample deviation rate shall also be the projected deviation rate for the population as a whole. If deviations from controls upon which the auditor intend to rely shall be detected, In such case, the cost auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

(a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls:

(b) Additional tests of control are necessary: or

(c) The potential risks of misstatement need to be addressed using substantive procedures.

For example,the concept of effectiveness of the operation of controls recognizes that some deviations in the way controls are applied by the entity may occur. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions and human error. The detected rate of deviation, in particular in comparison with the expected rate, may indicate that the control cannot be relied on to reduce risk at the assertion level to that assessed by the auditor.

11.11.3 Reassessing Sampling Risk

The cost auditor needs to consider whether errors in the population might exceed the tolerable error. To accomplish this, the cost auditor compares the projected population error to the tolerable error taking into account the results of other audit procedures relevant to the specific control or cost statement assertion. The projected population error used for the comparison in the case of substantive procedures is net of adjustments made by the entity. When the projected error exceeds tolerable error, the cost auditor reassesses the sampling risk and if that risk is unacceptable,he would consider extending the audit procedure or performing alternative audit procedures.

11.12 SAMPLING IN CIS /ERP ENVIRONMENT

Nature of Transaction

- Huge voluminous data for verification
- Large number of similar kind of transaction
- Transactions are clearly identifiable can be classified

Verification process

- Determining the Size of the sample
- Use of CAAT's and Statistical technique for determining the samples
- Fixing up Materiality levels
- Evaluation of Sample results
- Based on such evaluation results, either increase the substantive procedure or conclude reliance to be placed on the internal control.

If the cost auditor shall conclude that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

(a) Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or

(b) Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures

11.13 WHEN NOT TO SAMPLE

There are many audit procedures which do not involve sampling.

Inquiry and Observation

- ❖ Observing accounting procedures
- ❖ Discussing methods of accounting and reporting .

Analytical Review

- ❖ Procedures comparing records, reports and other information
- ❖ Re-computing or estimating amounts
- ❖ Reviewing trends in reporting
- ❖ Comparing similar businesses

One Hundred Percent Examination

- ❖ Reviewing all fixed asset purchases, where appropriate
- ❖ Examining all contracts, where there are a small number

Zero Percent Examination

- ❖ This occurs when the auditor determines that a type of receipt, deduction, exemption or other item does not need to be tested

11.14 DOCUMENTING THE SAMPLING PROCESS

The following should be stated whatever sampling procedures are used:

- ✓ The objectives of the procedure and the definitions of error
- ✓ The definition of the population (and the population value if relevant)
- ✓ How it was ensured that selection was made from a complete population
- ✓ The definition of the sampling unit
- ✓ The risk of incorrectly accepting a test result
- ✓ The tolerable error level or rate
- ✓ The size of the sample and the sampling interval
- ✓ The method of sample selection
- ✓ The nature, related causes and follow-up of errors found
- ✓ Sample evaluation procedures
- ✓ The overall audit conclusions

NOTE: All errors found above the tolerable error level should be included in the overallsummary of unadjusted errors schedule.

Apply the 80/20 rule to everything you do

What are your highest – value activities

By Richard A. Moran

CHAPTER- 12 USING THE WORK OF OTHER AUDITOR/ EXPERT

An entity may include in its cost statements the cost information of one or morecomponents such as a division, branch or subsidiary, which has been audited by a cost auditor other than the lead cost auditor/ other cost auditor of the entity. In such situations, the engagementteam will seek to rely on the work of the other auditor i.e. Internal auditor, Other auditor, Branch Auditor, Management experts or Statutory Auditor.

When the lead auditor/ branch auditor uses the work of another auditor, the cost auditor shoulddetermine how the work of the other auditor will affect the audit.When accepting appointment as the cost auditor, the firm, as the lead auditor, needs toconsider the extent of its involvement in the overall audit. The following factors need tobe considered:

- The materiality of the portion of cost statements being audited by the firm;
- The firm's degree of knowledge of the component's business;
- The risk of material misstatement in the cost statements of the component beingaudited by another cost auditor or other auditor; and
- The performance of additional audit procedures on the components which are being audited by another cost auditor or other auditor.

12.1 COST AUDITOR’S RESPONSIBILITY FOR THE AUDIT OF COST STATEMENTS

The cost auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by use of the work of the other auditors to provide direct assistance on the audit engagement or seeking indirect assistance by use of other auditor work. Although they may perform audit procedures similar to those performed by the cost auditor. SCAs, therefore, defines the conditions that are necessary for the cost auditor to be able to use the work of other auditors. It also defines the necessary work effort to obtain sufficient appropriate evidence that the work of the other auditor providing direct assistance is adequate for the purposes of the cost audit. The requirements are designed to provide a framework for the cost auditor’s judgments regarding the use of the work of other auditors to prevent over or undue use of such work.

Since the cost auditor has sole responsibility for the audit opinion expressed, the cost auditor needs to make the significant judgments in the audit engagement. Significant judgments include the following:

(a) Assessing the risks of material misstatement;

(b) Evaluating the sufficiency of tests performed;

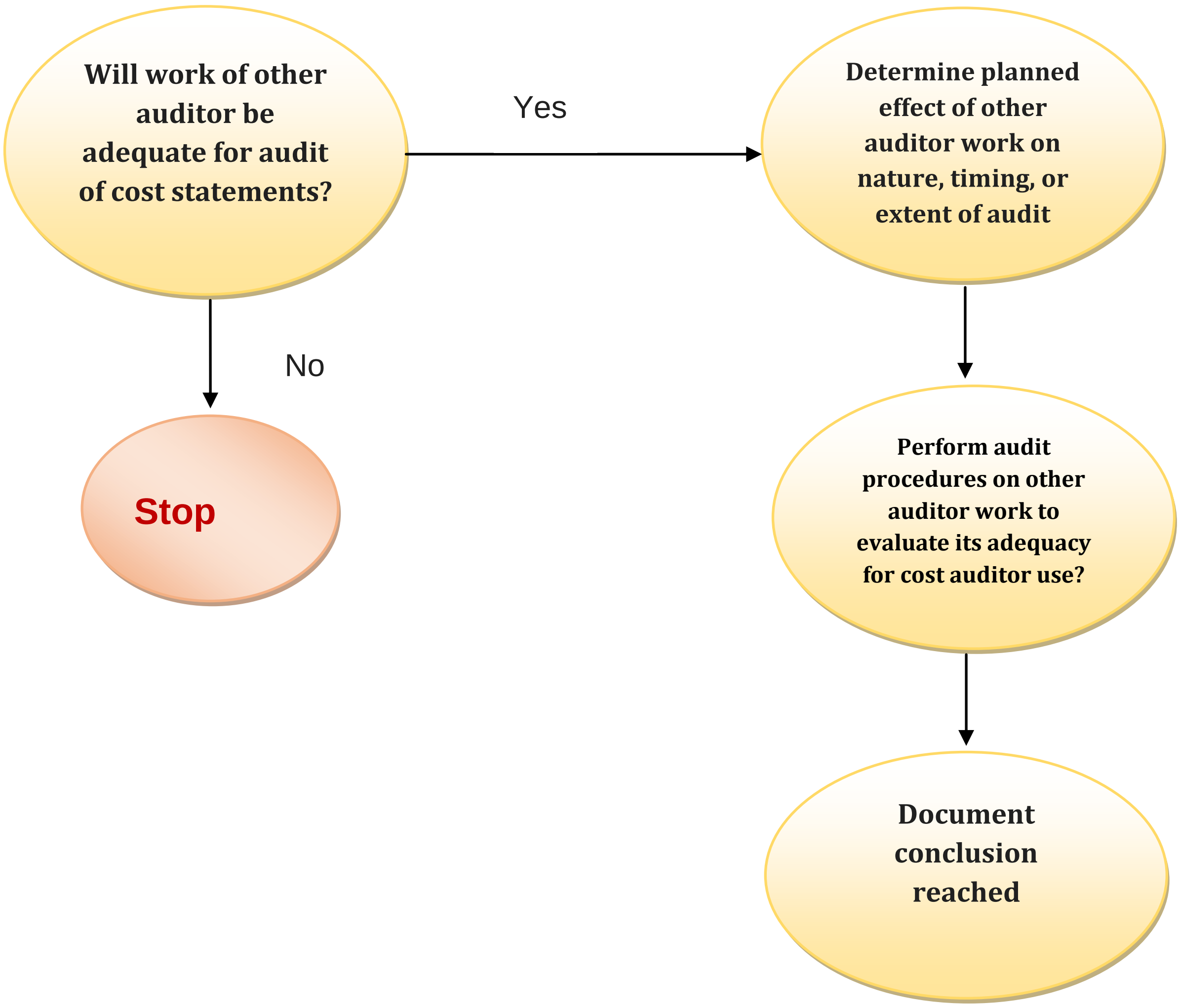
(c) Evaluating the appropriateness of management's use of the going concern assumption;

(d) Evaluating significant accounting and costing estimates; and

(e) Evaluating the adequacy of disclosures in the cost statements, and other matters affecting the cost auditor's report.

SCA–113 & SCA-114 deals with the use of work of internal auditor and cost auditor expert's work

The following figure exhibits how to use the work of Internal Auditor work



12.2 USING THE WORK OF INTERNAL AUDITOR (SCA -113)

In medium and larger entities, an internal audit department is often established to monitor the effectiveness of various aspects on internal control. The scope of internal audit activities could include;

- Monitoring of certain elements of internal control;
- Examination of operating and other related information;
- Review of operating activities:

- Review of compliance with law and regulations;
- Risk Management; and /or
- Governance

However, because internal auditor are hired by the entity and form part of internal control, they are not completely independent. Consequently, their work would not be relied upon to the same extent as that performed by cost audit team.

Factor to be considered by cost auditor while placing the reliance on cost auditor team;

Task	Considerations
Will Internal Audit work be Adequate for Cost Audit Purpose?	▪ What are the objectives and scope of internal audit function? ▪ How objective (independent) is the internal audit functions? ▪ Are the internal auditors technically competent? ▪ Will their work be carried out with due professional care? ▪ Is the communication between the internal and cost auditor effective?
What effect will reliance on Internal Audit work have on Cost Audit	Consider: • Nature and scope of specific work performed, to be performed, by internal auditor • Assessed risk of material misstatement at the assertion level for particular item of cost, cost heads , class of transaction, account balance and disclosure; and • Degree of subjectivity involved in evaluation of audit evidence gathered by internal auditor in support of relevant assertion
Evaluate the adequacy of internal control	• Did the internal auditors performing the work have adequate technical training and proficiency? • Was the work properly supervised, reviewed and documented? • Was adequately audit evidence obtained to enable the internal auditors to draw reasonable conclusion? • Were the conclusion reached appropriate in the circumstance? • Were any reports prepared by the internal auditors consistent with the results of the work performed? • Were any exceptions or unusual matters disclosed by the internal auditor

Task	Considerations
Documents Results	• Conclusion reached on the evaluation of adequacy of internal auditor work; and • Description of audit procedures performed by the cost auditor on that work.

Examples of work of the internal audit function that can be used by the cost auditor include the following:

- Testing of the operating effectiveness of controls
- Substantive procedures involving limited judgment
- Tracing transactions through the information system relevant to cost reporting
- Testing of compliance with regulatory requirements

Relevant Requirements of SCA 113 "***Using the work of Internal Auditor***" specifies the cost auditor's responsibilities if the cost auditor is using the work of Internal Auditor. These are reproduced below.

Para No.	Requirements
5.2	***The cost auditor shall not use the work of the internal audit function if the cost auditor determines that:*** ***(a) The organizational status and relevant policies and procedures of the internal audit function do not adequately support the objectivity of internal auditors;*** ***(b) The internal audit function lacks sufficient competence; or*** ***(c) The internal audit function does not apply a systematic and disciplined approach, including quality control.***
5.3	***As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the cost auditor shall consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the cost auditor's overall audit strategy and audit plan.***
5.4	***The cost auditor shall make all significant judgement in the audit engagement and, to prevent undue use of the work of the internal audit function, shall plan to use less of the work of the internal audit function and perform more of the work directly if:*** ***(a) The more judgment is involved in:*** ***(i) Planning and performing relevant audit procedures; and*** ***(ii) Evaluating the audit evidence gathered;*** ***(b) The higher the assessed risk of material misstatement at the***

Para No.	Requirements
	assertion level, with special consideration given to risks identified as significant; *(c)The less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and* *(d) The lower the level of competence of the internal audit functions.*
5.6	*The cost auditor shall communicate with those charged with governance as to how the cost auditor has planned to use the work of the internal audit function.*
5.12	*The cost auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors.*
5.13	*If using internal auditors to provide direct assistance is not prohibited by law or regulation, and the cost auditor plans to use internal auditors to provide direct assistance on the cost audit, the cost auditor shall evaluate the existence and significance of threats to objectivity and the level of competence of the internal auditors who will be providing such assistance. This shall include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity.*
5.14	*The cost auditor shall not use an internal auditor to provide direct assistance if:* *(a) There are significant threats to the objectivity of the internal auditor; or* *(b) The internal auditor lacks sufficient competence to perform the proposed work.*
5.16	*The cost auditor shall not use internal auditors to provide direct assistance to perform procedures that:* *(a) Involve making significant judgments in the audit;* *(b) Relate to higher assessed risks of material misstatement where the judgement required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited;* *(c) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or* *(d) Relate to decisions the cost auditor makes in accordance with this SCA regarding the internal audit function and the use of its work or direct assistance.*
5.17	*Having appropriately evaluated whether and, if so, to what extent internal auditors can be used to provide direct assistance on the audit, the cost auditor shall communicate with those charged with*

Para No.	Requirements
	governance an overview of the planned scope and timing of the audit, nature and extent of the planned use of internal auditors to provide direct assistance to reach a mutual understanding that such use is not excessive in the circumstances of the engagement.
5.18	*The cost auditor shall evaluate whether, in aggregate, using internal auditors to provide direct assistance to the extent planned, together with the planned use of the work of the internal audit function, would still result in the cost auditor being sufficiently involved in the audit, given the cost auditor's sole responsibility for the audit opinion expressed.*
5.19	*Prior to using internal auditors to provide direct assistance for purposes of the audit, the cost auditor shall:* *(a) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the cost auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the cost auditor; and* *(b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the cost auditor and inform the cost auditor of any threat to their objectivity.*
5.20	*The cost auditor shall direct, supervise and review the work performed by internal auditors on the engagement. In doing so, the cost auditor shall:* *(a) recognize that the internal auditors are not independent of the entity and be responsive to the outcome of the evaluation of the factors in paragraph 5.15; and* *(b) check back to the underlying audit evidence for some of the work performed by the internal auditors as part of review procedure.* *The direction, supervision, and review by the cost auditor of the work performed by the internal auditors shall be sufficient to satisfy that the internal auditors have obtained sufficient appropriate audit evidence to support the conclusions based on that work*
5.22	*If the cost auditor uses the work of the internal audit function, the cost auditor shall include in the audit documentation:* *(a) The evaluation of:* *(i) Whether the organizational status and relevant policies and procedures of the internal audit function adequately support the objectivity of the internal auditors;* *(ii) The level of competence of the internal audit function; and*

Para No.	Requirements
	(iii) Whether the internal audit function applies a systematic and disciplined approach, including quality control; ***(b) The nature and extent of the work used and the basis for that decision; and*** ***(c) The audit procedures performed by the cost auditor to evaluate the adequacy of the work used.***
5.23	***If the cost auditor uses internal auditors to provide direct assistance on the audit, the cost auditor shall include in the audit documentation:*** ***(a) The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance;*** ***(b) The basis for the decision regarding the nature and extent of the work performed by the internal auditors;*** ***(c) Who reviewed the work performed and the date and extent of that review;*** ***(d) The written agreements obtained from an authorized representative of the entity and the internal auditors under; and*** ***(e) The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.***

Competence of the internal audit function refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and in accordance with applicable professional standards. Factors that may affect the cost auditor's determination include the following:

(a) Whether the internal audit function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.

(b) Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.

(c) Whether the internal auditors have adequate technical training and proficiency in auditing. Relevant criteria may include, for example, the internal auditors' possession of a relevant professional designation and experience.

(d) Whether the internal auditors possess the required knowledge relating to applicable financial and cost reporting frameworks and whether the internal audit function possesses the necessary skills (for example, industry-specific knowledge) to perform work related to the entity's Cost Statements.

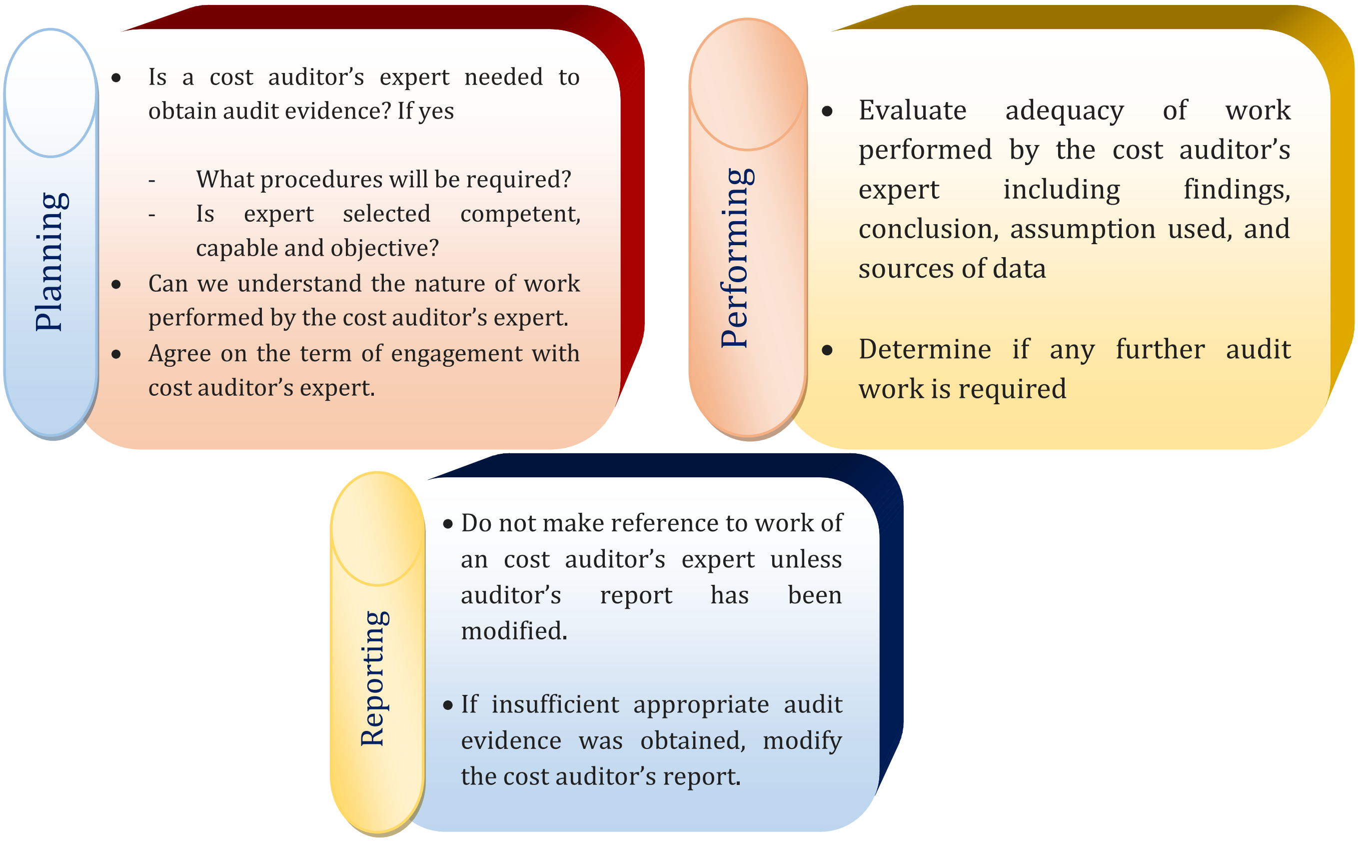
(e) Whether the internal auditors are members of relevant professional bodies that oblige them to comply with the relevant professional standards including continuing professional development requirements.

In discussing the planned use of their work with the internal audit function as a basis for coordinating the respective activities, it may be useful to address the following:

- The timing of such work
- The nature of the work performed
- The extent of audit coverage
- Materiality for the Cost Statements as a whole (and, if applicable, materiality level or levels for particular Items of cost or disclosures), and performance materiality
- Methods of item selection and sample sizes
- Documentation of the work performed
- Review and reporting procedures

12.3 USING THE WORK OF COST AUDITOR'S EXPERT

SCA -114 stipulates the cost auditor's responsibilities regarding the use of an individual or organization's work in a field of expertise other than accounting or auditing, when that work is used to assist the cost auditor in obtaining sufficient appropriate audit evidence.



In some situations, the cost auditor may require expertise (other than accounting or auditing) to obtain sufficient appropriate audit evidence. Expertise in a field other than accounting and auditing may include expertise in relation to such matter as:

(a) Determination of installed / achievable capacity of plant, machineries, process, product etc;

(b) Determination and or verification of consumption norms of various input like material, labour, machine hours, technical standards etc;

(c) Impact on consumption norms of various input due to change in production process, change in technology, or substitute of major input material(s) etc;

(d) Efficiency of machines, boiler etc. which has significant impact on determination of machine hour rate, labour hour rate and or utilities consumption pattern;

(e) Estimation of oil and gas reserve; or

(f) The interpretation of contracts, law and regulations.

An expert may be needed to assist the cost auditor in one or more of the following;

(a) Obtaining an understanding of entity and its environment, including the internal control

(b) Identifying and assessing the risk of material misstatements

(c) Determining the overall response to assessed risks at the cost statement level

(d) Designing and performing further audit procedures to respond to assessed risks at assertion level, comprising tests of controls or substantive procedures

(e) Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the cost statements.

Factor to be considered relating to engaging a cost auditor's expert are:

Consider	Discussion
Is a cost auditor's expert needed to obtain audit evidence?	Consider need in relation to: • Obtaining an understanding of the entity, including internal control; • Identifying/assessing the risks of material misstatement; • Determining/implementing overall responses to assessed risks at the cost statement level; • Designing/performing further audit procedures to respond to assessed risks at the assertion level; and • Evaluating the sufficiency/appropriateness of audit evidence obtained to form an opinion.

Consider	Discussion
What audit procedures are required?	• Competence relates to the nature and level of expertise of the cost auditor's expert. • Capability relates to the ability of the cost auditor's expert to exercise that competence in the circumstances of the engagement (e.g. geographic location and the availability of time and resources). • Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business judgment of the cost auditor's expert. Other factors to consider include: • Personal experience with previous work of that expert; • Discussions with that expert; • Discussions with others familiar with that expert's work; • Knowledge of that expert's qualifications, membership of a professional body orindustry association, license to practice, or other forms of external recognition; • Published papers or books written by that expert; and • The cost auditor's firm's quality control policies and procedures (if any)
Is chosen Auditor's expert competent, capable and objective	Is there sufficient understanding of the cost auditor's expert's field of work to: • Plan the audit; and • Review the results of work performed
Agree on Terms of Engagement	In establishing the terms of engagement, consider factors such as the following: • Access of the cost auditor's expert to sensitive or confidential entity information; • The respective roles or responsibilities of the auditor and the auditor's expert; • Any multi-jurisdictional, legal, or regulatory requirements; • The complexity of the work required; • Previous experience by the auditor's expert with the entity; and • The extent of the auditor's expert's work, and its significance

Consider	Discussion
	in the context of the audit. The written agreement would address: • Nature, scope, and objectives of expert's work; • Respective roles and responsibilities; • Nature, timing, and extent of communication, including the report format; and • Need for confidentiality.

When management has used a management's expert in preparing the cost statements, the cost auditor's decision on whether to use an expert may also be influenced by such factor as;

(a) The nature, scope and objectives of the management's expert' s work

(b) Whether the management's expert is employed by the entity, or is a party engaged by it provide relevant services.

(c) The extent to which management can exercise control or influence over the work of the management's expert.

(d) The management expert's competence and capabilities.

(e) Whether the management's expert is subject to technical performance standards or other professional or industry requirements.

(f) Any controls within the entity over the management's expert's work

Cost Auditor's Expert: An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the cost auditor to assist in obtaining sufficient appropriate audit evidence. Cost auditor's expert may be either an internal expert (who is a partner or staff, including temporary staff) of the cost auditor's firm, or cost auditor's external expert.

Expertise: Skills, knowledge and experience in a particular field.

Management's Expert: An individual or organisation possessing expertise in a field other than accounting, and auditing, whose work in that field is used by the entity to assist the entity in preparing the cost statements.

Relevant Requirements of SCA-114 "Using the work of Cost Auditor's Expert" is to apply whether to use the work of a cost auditor's expert and if using the work of a cost auditor's expert, to determine whether that work is adequate for the cost auditor's purpose are reproduced below.

Para No	Relevant Requirements
5.1	***If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the cost auditor shall determine whether to use the work of a cost auditor's expert.***
5.2	***The nature, timing and extent of the cost auditor's procedures with respect to the requirements will vary depending on the circumstances. In determining the nature, timing and extent of those procedures, the cost auditor shall consider matters including:*** ***(a) The nature of the matter to which that expert's work relates;*** ***(b) The risks of material misstatement in the matter to which that expert's work relates;*** ***(c) The significance of that expert's work in the context of the audit;*** ***(d) The cost auditor's knowledge of and experience with previous work performed by that expert; and*** ***(e) Whether that expert is subject to the cost auditor's firm's quality control policies and procedures.***
5.3	***The cost auditor shall evaluate whether the cost auditor's expert has the necessary competence, capabilities and objectivity for the cost auditor's purposes. In the case of cost auditor's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity.***
5.4	***The cost auditor shall obtain a sufficient understanding of the field of expertise of the cost auditor's expert to enable the cost auditor to:*** ***(a) Determine the nature, scope and objectives of that expert's work for the cost auditor's purposes; and*** ***(b) Evaluate the adequacy of that work for the cost auditor's purposes.***
5.5	***The cost auditor shall agree, in writing when appropriate, on the following matters with the cost auditor's expert:*** ***(a) The nature, scope and objectives of that expert's work;***

Para No	Relevant Requirements
	(b) The respective roles and responsibilities of the cost auditor and that expert; ***(c) The nature, timing and extent of communication between the cost auditor and that expert, including the form of any report to be provided by that expert; and*** ***(d) The need for the cost auditor's expert to observe confidentiality requirements.***
5.6	***The cost auditor shall evaluate the adequacy of the cost auditor's expert's work for the cost auditor's purposes, including:*** ***(a) The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;*** ***(b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and*** ***(c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.***
5.7	***If the cost auditor determines that the work of the cost auditor's expert is not adequate for the cost auditor's purposes, the cost auditor shall:*** ***(a) Agree with that expert on the nature and extent of further work to be performed by that expert; or*** ***(b) Perform further audit procedures appropriate to the circumstances.***
5.8	***The cost auditor shall not refer to the work of cost auditor's expert in cost auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the cost auditor shall indicate in the report that the reference does not reduce the cost auditor's responsibility for the audit opinion.***
5.9	***If the cost auditor makes reference to the work of cost auditor's expert in the report because such reference is relevant to an understanding of a modification to the cost auditor's opinion, the cost auditor shall indicate in the report that such reference does not reduce the cost auditor's responsibility for that opinion.***

12.4 EVALUATION OF WORK OF PERFORMED BY EXPERT

When evaluating the objectivity of cost auditor's external expert, it may be relevant to:

(a) Inquiry about any known interests or relationships that the entity has with the cost auditor's external expert.

(b) Discuss with that expert any applicable safeguards, including any professional requirements that apply to that expert. Interests and relationships that may be relevant to discuss with the expert include:

- (i) Financial interests
- (ii) Business and personal relationships
- (iii) Provision of other services by the expert, including by the organization in the case of an external expert that is an organization

In some cases, it may also be appropriate for the cost auditor to obtain a written representation from the external expert about any interests or relationships with the entity of which that expert is aware.

Evaluate adequacy of work performed by expert

Evaluate relevance / reasonableness of:

- ❖ Expert's findings / conclusion and consistency with other audit evidence
- ❖ Key assumption and methods used in the circumstances
- ❖ Source data including its accuracy
- ❖ Agree with expert on nature/ extent of any further work to be performed

If work not adequate, plan additional audit procedures appropriate to the circumstance

If the results of the expert's work are unsatisfactory or inconsistent with other evidence, the cost auditor should resolve the matter. This may involve;

- ❖ Discussion with the entity and the expert;
- ❖ Applying additional audit procedures;
- ❖ Applying additional another experts; or
- ❖ Modifying the cost auditor's report.

Price is what you pay, Value is what you get

By Warren Buffett

CHAPTER - 13 RISK ASSESSMENT AND RESPONSE

Audit Risk is the risk of expressing an inappropriate audit opinion on cost statements that are materially misstated. The objective of audit is to reduce this risk to an acceptably low level. The cost auditors may certify that the cost statements give a true and fair view when they actually do not exists in letter and spirit. In other words the cost statements contain a significant error or misstatement which the cost auditor(s) have failed to detect.

Audit Risk = Inherent Risk x Control Risk x Detection Risk

Audit risk is a function of the risk of material misstatement and detection risk. The risk of material misstatement has two components viz. Inherent Risk and Control risk.

- Inherent Risk is the risk of a material misstatement in the cost statements arising due to error or omission as a result of factors other than the failure of internal controls, such as
  - Totalling mistake
  - Mistake to correctly carry the opening balances
  - Failure to account for all expenses relating to the year
  - Wrong assessment of capacity
- Control Risk is the risk of a material misstatement in the cost statements arising due to absence or failure in the operation of relevant internal controls of the entity, such as
  - Failure to perform supervisory or authentication checks
  - Failure to verify the veracity & accuracy of information
  - Failure to control frauds [fake staff bills, fake production, fake sales, fake consumption,
- Detection Risk is the risk that the auditors fail to detect a material misstatement in the cost statements.

Cost auditor must apply audit procedures to detect material misstatements in the cost statements whether due to fraud or error. To reduce audit risk to an acceptably low level, the cost auditor is required to:

- Assess the risks of material misstatement;
- Limit detection risk. This may be achieved by performing procedures that respond to the assessed risks of material misstatement, both at the cost

statement level and at the assertion level for cost heads, items of cost, and disclosures;

- Inherent risk assessment should be made before the commencement of the audit of cost statements to ensure that the existence of a material misstatement either individually or when aggregated with other misstatements is detected and also an assurance to the satisfaction of the auditor derived that it is nil or acceptable to a lower level so as not to distort the cost statements significantly;
- The cost auditor should assess the controls prevailing at various levels to ensure and satisfy that the operating and financial controls are adequate and acceptable;
- Study the reports of the Internal Auditors, Statutory Auditors and other agencies being engaged by the Company and address the scope, nature and depth of audit procedures to be applied to perform his duties efficiently as a cost auditor;
- As far as the risk assessment is concerned, the engagement partner should directly involve himself together with team who will involve in the audit. This is essential because, while conducting the enquiries about the control aspects, the officials of the auditee at various levels may fail to provide complete information. It is the efficiency of the auditor to bring out the details to his satisfaction so as to frame the appropriate mind-set and opinion in determining the depth of the audit to be undertaken in each of the audit environment concerned.

Based on the above, the partner/ proprietor of the firm should plan the time schedule to complete the risk assessment as this forms the foundation of the whole audit completion.

13.1 CONDITIONS AND EVENTS THAT MAY INDICATE RISKS OF MATERIAL MISSTATEMENT

The following are examples of conditions and events that may indicate the existence of risks of material misstatement. The examples provided cover a broad range of conditions and events; however, not all conditions and events are relevant to every audit engagement and the list of examples is not necessarily complete. *(Refer SCA-117-Appendix 2)*

- ❖ Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies
- ❖ Operations exposed to volatile markets
- ❖ Operations that are subject to a high degree of complex regulations
- ❖ Going concern and liquidity issues including loss of significant customers
- ❖ Constraints on the availability of resources, manpower and credit facility
- ❖ Changes in the industry in which the entity operates

- ❖ Changes in the supply chain
- ❖ Developing or offering new products or services, or moving into new lines of business
- ❖ Expanding into new locations
- ❖ Changes in the entity such as large acquisitions or reorganizations or other unusual events
- ❖ Entities or business segments likely to be sold or plant and facilities likely to be leased
- ❖ The existence of complex alliances and joint ventures
- ❖ Use of off balance sheet finance, special-purpose entities, and other complex financing arrangements
- ❖ Significant transactions with related parties
- ❖ Lack of personnel with appropriate accounting, recording and apportionment of cost and reporting skills
- ❖ Changes in key personnel including departure of key executives
- ❖ Deficiencies in internal control, especially those not addressed by management
- ❖ Inconsistencies between the entity's IT strategy and its business strategies
- ❖ Changes in the IT environment
- ❖ Installation of significant new IT systems related to financial and cost reporting
- ❖ Inquiries into the entity's operations or cost reporting framework by regulatory or government bodies
- ❖ Past misstatements, history of errors or significant adjustments at period end
- ❖ Significant non-routine or non-systematic transactions including intercompany transactions and large cost transactions at period end
- ❖ Cost transactions that are recorded based on management's intent, for example, allocation and apportionment of costs to unrelated products, wrong classification of expenses, items of cost and cost heads
- ❖ Application of new techniques of costing
- ❖ Cost measurements that involve complex processes
- ❖ Events or transactions that involve significant measurement uncertainty, including cost accounting estimates

The cost auditors must consider all the misstatements, or errors, they detect during the course of their audit work and make a judgement about how they could affect the cost statements. This will involve discussion with the management about amending the cost statements where individual misstatements are material. If the misstatements are individually small this will involve deciding whether, collectively, they are significant enough to affect the presentation of the cost statements as whole ; *lots of small errors can add up to a large one!*

Types of Risks

13.1.1 Risk at the Assertion Level

The term 'assertion' means what management have asserted to be true. For example, management will say (at the cost statement assertion level) that all item of cost / consumption / overhead that should have been recorded, have been recorded. An assertion is therefore made by management and it is up to the cost auditor to corroborate this assertion by way of audit evidence.

13.1.2 Risk Assessment

The purpose of risk assessment procedures is to identify and assess risks of material misstatement. This is achieved through understanding the entity and its environment, including internal control. Information may be obtained from external sources, such as the industrial benchmarking data and trade publications, and from internal sources such as discussions with key personnel. This understanding of the entity becomes a continuous, dynamic process of gathering, updating and analyzing information throughout the cost audit.

Risk assessment procedures provide audit evidence to support the assessment of risks at the cost statement and assertion levels. However, this evidence does not stand alone. Evidence obtained from risk assessment procedures is supplemented by further cost audit procedures (that respond to the risks identified) such as tests of controls and/or substantive procedures. The cost auditor uses professional judgment to determine the risk assessment procedures to be performed, and the scope or depth of understanding of the entity that is required.

The three risk assessment procedures:

(d) Inquiries of management and others
(e) Observation and Inspection
(f) Analytical Procedures

Changes due to circumstances can change the level of risk and may cause higher risk to controls which may leads to significant risks to cost reporting framework such as the followings:

- *Change in operating environment:* Changes in the regulatory or the operating environment can result in changes in competitive pressures and significantly different risks.

- *New personnel:* New personnel may have different focus on or understanding of internal control.

- *Rapid growth:* Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.

- *New Technology:* Incorporating new technologies into production processes or information systems may change the risk associated with control activities.

- *New business models, products, or activities:* Entering into business areas or transactions with which an entity has little experience may introduce new risk associated with controls.

- *Corporate Restructuring:* Restructuring may be accompanied by diversification, business integration, process integration and changes in supervision or segregation of duties that may change the risk associated with control functions.

- *Expanded foreign operations:* The expansion or acquisition of foreign operations carries new and often unique risk that may affect controls, for example transfer pricing issues.

- *New cost accounting pronouncements:* Adoption of new cost accounting or changing cost accounting principles may affect the risks in preparing cost statements.

13.2 CHARACTERISTICS OF FRAUD

(i) Misstatements in the cost statements can arise from either error or fraud. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement is intentional or unintentional.

(ii) Although fraud is a broad legal concept, for the purposes of the Standard on Cost Auditing, the cost auditor is concerned with fraud that causes a material misstatement in the cost statements. Two types of intentional misstatements are relevant to the cost auditor

- Misstatements resulting from fraudulent cost or revenue reporting; and
- Misstatement resulting from misappropriation of assets.

Although the cost auditor may suspect or, in rare cases, identify the occurrence of fraud, the cost auditor does not make legal determination of whether fraud has actually occurred.

13.3 RESPONSIBILITY FOR PREVENTION AND DETECTION OF FRAUD

The primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the entity. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behaviour which can be reinforced by an active oversight by those charged with governance. Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the cost reporting process, such as efforts by the management to understate or overstate costs in order to influence the perceptions of analysts as to the entity's performance and profitability.

13.3.1 Responsibilities of the Cost Auditor

A cost auditor conducting an audit in accordance with Standards on Cost Auditing is responsible for obtaining reasonable assurance that the cost statements taken as a whole are free from material misstatement, whether caused by error or fraud. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the cost statements may not be detected, even though the audit is properly planned and performed in accordance with the Standards on Cost Auditing.

The potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the cost auditor.

Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the cost auditor to believe that audit evidence is persuasive when it is, in fact, false. The cost auditor's ability to detect a fraud depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the cost auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the cost auditor to determine whether misstatements in judgment areas such as cost estimates are caused by error or fraud.

Furthermore, the risk of the cost auditor for not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate cost records, present fraudulent cost information or override control procedures designed to prevent similar frauds by other employees.

When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this Standard on Cost Auditing are designed to assist the cost auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

Important Definitions:- These are some relevant definitions in context of Risk Assessment and Risk Response:

Error: An unintentional misstatement in cost statements, including the omission of an amount or a disclosure.

Fraud: An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

Fraud risk factors: Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

Professional Judgement: The application of relevant training, knowledge, experience and objectivity, within the context provided by cost auditing standards, cost accounting standards and ethical requirements, in making informed decision about the courses of action that are appropriate in the circumstances of the audit engagement.

Professional Skepticism: An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatements due to error or fraud, and a critical assessment of audit evidence.

Risk Assessment: The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the overall cost statement level and at the assertion level including items of cost, cost heads and disclosure thereof.

Significant Risk: An identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

Test of Controls: At the assertion level certain audit procedures are designed in preventing, detecting and correcting, material misstatements to evaluate the operating effectiveness of controls.

13.4 AREAS OF MISSTATEMENTS IN COST STATEMENTS, EITHER DUE TO ERROR OR FRAUD

There is no literature that has given an exhasutive list of areas of mistatements in cost records and cost statements, arising either due to error or fraud. However, for the benefit of cost auditors, a tentative list of such areas is given below.

- Understatement or overstatement of installed capacties

- Misstatement in measurement, classification, allocation, apportionment and absorption of costs
- Misstatement of costs with a view to claim higher subsidies or evade taxes or due to error
- Over-valuation or under-valuation of inventory either due to error or with a view to manipulate profits and taxes
- Wrong consumption of raw materials, utilities and other inputs resulting in misstatement in cost of production
- Misstatement in production and sales records to evade taxes
- Wrongful recognition of revenues
- Wrong classification of joint-products or by-products
- Significant variations in physical inventories vis-a-vis stock statements
- Non or wrong recognition of idle capacities, idle facilities, idle manpower, etc.
- Overstatement or understatement of scrap, defectives, wastages, spoilage, etc.
- Non-recognition of cases of thefts, pilfirage, etc., if any
- Recognition of abnormal costs as normal costs or vice versa
- Recognition of non-cost items as costs or vice versa
- Inappropriate traceability of costs to particular cost objects
- Misstatement in arm's length price in relation to transactions with related parties
- Wrong certification of stocks lying with third parties
- Over or under invoicing of purchases or sales
- Recognition of fake bills of purchases of goods and services
- Recognition of costs not actually incurred
- Treatment of capital as revenue or vice-versa
- Booking of fake manpower costs not actually engaged
- Wrongful recognition of group companies' costs or assets
- Recognition of dead or unserviceable stocks as 'good' inventories or vice versa
- Recognition of third party stocks as own stocks or vice versa
- Non-booking of costs already accrued
- Mistatement in quantities and values showing material mismatch with cost estimates
- Treatment of self-manufactured materials, components, sub-assemblies, tools, etc. as purchases
- Valuation of international transactions at wrong forex rates
- Wrongful recognition of subsidies, grants, incentives, etc.
- Recognition of imputed costs
- Recognition of defectives production as good ones or vice versa
- Recognition of semi-finished goods as finished goods or vice versa
- Under or overstating life of assets [or additions to or deletion of assets] resulting

in over or undercharging of depreciation or amortization

Related Requirements of *SCA-109 for* ***"Cost Auditor's Responsibility relating to Fraud"***arereproduced below;

Para No	Related Requirements
5.2	***Unless the cost auditor has reason to believe the contrary the cost auditor may accept records and documents as genuine. If conditions identified during the audit cause the cost auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the cost auditor, the cost auditor shall investigate further.***
5.6	***The cost auditor shall make inquiries from management regarding:*** ***1. Management's assessment of the risk that the cost statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments;*** ***2. Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or material consumption, scrap sales, stock valuation, other items of cost or revenue, or disclosures for which a risk of fraud is likely to exist;*** ***3. Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and*** ***4. Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.***
5.9	***Unless all of those charged with governance are involved in managing the entity, the cost auditor shall:*** ***(a) Obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.*** ***(b) Make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. These inquiries are made in part to corroborate the responses to the inquiries from management.***
5.12	***The cost auditor shall evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicate that one or more fraud risk factors are present. While fraud***

Para No	Related Requirements
	risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud.
5.16	*Management is in a unique position to perpetrate fraud because of Management's ability to manipulate cost records and prepare fraudulent cost statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk.*
5.17	*Irrespective of the cost auditor's assessment of the risks of management override of controls, the auditor shall design and perform cost audit procedures to:* *(a) Test the appropriateness of cost records, basis for measurement, allocation, apportionment and absorption of costs adopted in the preparation of the cost statements. In designing and performing audit procedures for such tests, the cost auditor shall make inquiries of individuals involved in the cost reporting framework about inappropriate or unusual activity relating to the measurement and presentation of costs;* *(b) Review costing estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the cost auditor shall:* *i) Evaluate whether the judgments and decisions made by management in making the costing estimates included in the cost statements, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the cost auditor shall reevaluate the costing estimates taken as a whole; and* *ii) Perform a retrospective review of management judgments and assumptions related to significant costing estimates reflected in the cost statements of the prior year.* *(c) For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the cost auditor's understanding of the entity and its environment and other*

Para No	Related Requirements
	information obtained during cost audit, the cost auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent cost reporting or to conceal misappropriation of assets.
5.20	*When the cost auditor identifies a misstatement, the cost auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the cost auditor shall evaluate the implications of the misstatement in relation to other aspects of the cost audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence.*
5.21	*If the cost auditor identifies a misstatement, whether material or not, and the cost auditor has reason to believe that it is or may be the result of fraud and that management (in particular, senior management) is involved, the cost auditor shall reevaluate the assessment of the risks of material misstatement due to fraud and its resulting impact on the nature, timing and extent of cost audit procedures to respond to the assessed risks. The cost auditor shall also consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained.*
5.23	*If, as a result of a misstatement resulting from fraud or suspected fraud, the cost auditor encounters exceptional circumstances that bring into question the cost auditor's ability to continue performing the cost audit, the cost auditor shall:* *(a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the cost auditor to report to the person or persons who made the cost audit appointment or, in some cases, to regulatory authorities;* *(b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and* *(c) If the cost auditor withdraws:* *(i) Discuss with the appropriate level of management and those charged with governance, the cost auditor's withdrawal from the engagement and the reasons for the withdrawal; and* *(ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the cost auditor's*

Para No	Related Requirements
	withdrawal from the engagement and the reasons for the withdrawal.
5.29	***The cost auditor's documentation of the understanding of the entity and its environment and the assessment of the risks of material misstatement shall include:*** ***(a) The significant decisions reached during the discussion among the audit team regarding the susceptibility of the entity's cost statements to material misstatement due to fraud; and*** ***(b) The identified and assessed risks of material misstatement due to fraud at the cost statement level and at the assertion level.***
5.30	***The cost auditor's documentation of the responses to the assessed risks of material misstatement shall include:*** ***(a) The overall responses to the assessed risks of material misstatement due to fraud at the cost statement level and the nature, timing and extent of cost audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and*** ***(b) The results of the audit procedures, including those designed to address the risk of management override of controls.***

13.5 FRAUDULENT COST REPORTING FRAMEWORK

Fraudulent cost reporting involves intentional misstatements including omissions of amounts or disclosures in cost statements to deceive its users. It can be caused by the efforts of management to manage cost records in order to deceive users by influencing their perceptions as to the entity's performance and profitability. Such act may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent cost reporting. Such a situation could occur when, due to pressures to meet market expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent cost reporting by materially misstating the cost statements. In some entities, management may be motivated to manage earnings or cost by a material amount to minimize tax or to inflate costs to get benefits from the public authorities or does not want the regulatory authorities to understand their product margin.

Fraudulent cost reporting may be accomplished by the following:

- Manipulation, falsification (including forgery), or alteration of costing records or supporting documentation from which the cost statements are prepared.

- Misrepresentation in, or intentional omission from, the cost statements of events, transactions or other significant information.
- Intentional misapplication of costing principles relating to classification, allocation of cost, apportionment of cost, manner of presentation, or disclosure.

Fraudulent cost reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

- Recording fictitious entries or adjustments, particularly close to the end of an accounting period, to manipulate margin in cost statements, operating results, tax liabilities or achieve other objectives.
- Inappropriately adjusting assumptions and changing judgments used to estimate cost statements.
- Omitting, advancing or delaying recognition in the cost statements of events and transactions that have occurred during the reporting period.
- Concealing, or not disclosing, facts that could affect the amounts recorded in the cost statements.
- Engaging in complex transactions that are structured to misrepresent margin in cost statements or performance of the entity.
- Altering records and terms related to significant and unusual transactions.

13.6 EVALUATION OF FRAUD RISK FACTORS

The fact that fraud is usually concealed can make it very difficult to detect. Nevertheless, the cost auditor may identify events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud (fraud risk factors). For example:

- The need to manage earnings or cost by a material amount to minimize tax
- The need to manage cost so that regulatory authorities do not understand their product margin for price fixation or ascertainment of subsidy levels

Fraud risk factors cannot easily be ranked in order of importance. The significance of fraud risk factors varies widely. Some of these factors will be present in entities where the specific conditions do not present risks of material misstatement. Accordingly, the determination of whether a fraud risk factor is present and whether it is to be considered in assessing the risks of material misstatement of the cost statements due to fraud requires the exercise of professional judgment.

The risk factors may be classified based on the three conditions that are generally present when fraud exists:

- An incentive or pressure to commit fraud;
- A perceived opportunity to commit fraud; or
- An ability to rationalize the fraudulent action.

Risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the cost auditor. Nevertheless, the cost auditor may become aware of the existence of such information.

The size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of relevant fraud risk factors. For example, in the case of a large entity, there may be factors that generally constrain improper conduct by management, such as:

- Effective oversight by those charged with governance
- An effective internal audit function
- The existence and enforcement of a written code of conduct

Furthermore, fraud risk factors considered at a business segment operating level may provide different insights when compared with those obtained when considered at an entity-wide level.

Material misstatement due to fraudulent reporting relating to revenue recognition often results from an overstatement of revenues through, for example, premature revenue or cost recognition or recording fictitious revenues or cost, It may result also from an understatement of revenues or costs through, for example, improperly shifting revenues or costs to a later period.

The risks of fraud in revenue or cost recognition may be greater in some entities than others. For example, there may be pressures or incentives on management to commit fraudulent reporting through inappropriate revenue or cost recognition in the case of listed entities when, for example, performance is measured in terms of year over year revenue growth or profit.

The presumption that there are risks of fraud in revenue or cost recognition may be rebutted. For example, it may be concluded that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, annual sale of scrap or wastage.

13.7 OVERALL RESPONSE

Determining overall responses to address the assessed risks of material misstatement due to fraud generally includes the consideration of how the overall conduct of the cost audit can reflect increased professional skepticism, for example, through:

- Increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.

- Increased recognition of the need to corroborate management explanations or representations concerning material matters.

It also involves more general considerations apart from the specific procedures otherwise planned; these considerations include the matters discussed below.

13.7.1 Assignment and Supervision of Personnel

The cost auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with specialized skill and knowledge, such as forensic and IT knowledge, or by assigning more experienced individuals to the engagement.

The extent of supervision reflects the cost auditor's assessment of risks of material misstatement due to fraud and the competencies of the engagement team members performing the work.

13.7.2 Unpredictability in the Selection of Cost Audit Procedures

Incorporating an element of unpredictability in the selection of the nature, timing and extent of cost audit procedures to be performed is important as individuals within the entity who are familiar with the cost audit procedures normally performed on engagements may be more able to conceal fraudulent cost reporting. This can be achieved by, for example:

- Performing substantive procedures on selected cost records and assertions not otherwise tested due to their materiality or risk.
- Adjusting the timing of cost audit procedures from that otherwise expected.
- Using different sampling methods.
- Performing cost audit procedures at different locations or at locations on an unannounced basis.

13.7.3 Other Matter Related to Fraud

Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example:

- Concerns about the nature, extent and frequency of management's assessments of the controls in place to prevent and detect fraud and of the risk that the cost statements may be misstated.
- A failure by management to appropriately address identified significant deficiencies in internal control, or to appropriately respond to an identified fraud.

- The cost auditor's evaluation of the entity's control environment, including questions regarding the competence and integrity of management.
- Actions by management that may be indicative of fraudulent cost reporting, such as management's selection and application of cost accounting policies that may be indicative of management's effort to manage profitability and performance in order to deceive cost statement users by influencing their perceptions as to the entity's performance and profitability.
- Concerns about the adequacy and completeness of the authorization of transactions that appear to be outside the normal course of business.

Related Requirements of *SCA-117 for* ***"Identifying and Assessing the Risks of Material Misstatements"***arereproduced below;

Para No	Related Requirements
5.1	***The cost auditor shall perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the cost statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.***
5.5	***Where the cost auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor shall determine whether changes have occurred since the previous audit that may affect its relevance to the current audit.***
5.6	***The audit partner and other key audit team members shall discuss the susceptibility of the entity's cost statements to material misstatement, and the application of the applicable cost reporting framework to the entity's facts and circumstances. The audit partner shall determine which matters are to be communicated to audit team members not involved in the discussion.***
5.7	***The cost auditor shall obtain an understanding of whether the entity has a process for:*** ***(a) Identifying business risks relevant to cost reporting objectives;*** ***(b) Estimating the significance of the risks;*** ***(c) Assessing the likelihood of their occurrence; and*** ***(d) Deciding about actions to address those risks.***
5.15	***The cost auditor shall identify and assess the risks of material misstatement at:***

Para No	Related Requirements
	(a) the cost statement level; and (Ref: Para. 6.54 – 6.55) ***(b) the assertion level for classes of transaction, cost head and disclosures,***
5.16	***For this purpose, the cost auditor shall:*** ***(a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, cost head and disclosures in the cost statements;*** ***(b) Assess the identified risks, and evaluate whether they relate more pervasively to the cost statements as a whole and potentially affect many assertions;*** ***(c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the cost auditor intends to test; and*** ***(d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.***
5.18	***In exercising judgment as to which risks are significant risks, the cost auditor shall consider at least the following:*** ***(a) Whether the risk is a risk of fraud;*** ***(b) Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;*** ***(c) The complexity of transactions;*** ***(d) Whether the risk involves significant transactions with related parties;*** ***(e) The degree of subjectivity in the measurement of cost information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and*** ***(f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.***
5.21	***The cost auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the cost auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is***

Para No	Related Requirements
	inconsistent with the audit evidence on which the auditor originally based the assessment, the cost auditor shall revise the assessment and modify the further planned audit procedures accordingly.
5.22	***The cost auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the cost auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the cost auditor shall revise the assessment and modify the further planned audit procedures accordingly.***
5.23	***The cost auditor shall include in the audit documentation:*** ***(a) The discussion among the audit team, and the significant decisions reached;*** ***(b) The identified and assessed risks of material misstatement at the cost statement level and at the assertion level; and*** ***(c) The risks identified, and related controls about which the cost auditor has obtained an understanding.***

13.8 DEVELOPING THE RESPONSIVE AUDIT PLAN

Professional judgment and careful thought are required to develop an audit plan that responds appropriately to the assessed risks. The time spent developing an appropriate plan will almost certainly result in a more effective and efficient audit and less time being spent by staff.

There are three general steps the cost auditor would take in developing the plan:

Step 1—Respond to assessed risks at the cost statement level

The first step is to develop an appropriate overall response to assessed risks at the cost statement level. Because these risks are pervasive, a moderate or high level of risk assessment will generally result in additional work being required for virtually every cost statement area.

Step 2—Identify specific procedures required for material cost statement areas

Before developing the detailed response to assessed risks, the cost auditor may find it helpful to consider the critical area of cost statement at whole.

Step 3—Determine the nature and extent of audit procedures required

The third step is to use professional judgment to choose the appropriate mix of procedures and extent of testing required to respond appropriately to the assessed risks at the assertion level.

13.9 RESPONDING TO THE RISK OF FRAUD

The risk of fraud (including management override) can exist in virtually any entity, and needs to be addressed when developing the audit plan. The first step is to assess the potential risk from fraud, and then to design an appropriate overall and detailed response. The cost auditor is required to treat assessed risks of material misstatement due to fraud as significant risks. A significant risk requires the cost auditor to:

- ❖ Obtain an understanding of the entity's related controls, including control activities, relevant to such risks; and
- ❖ Perform substantive procedures that are specifically responsive to that risk.

When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details.

In assessing the potential risk and appropriate response to fraud, the cost auditor would consider the following:

- ❖ Overall responses already developed to address risks assessed at the cost statement level;
- ❖ Specific responses already developed in relation to other risks assessed at the assertion level;
- ❖ The fraud scenarios (if any) developed during the planning discussions;
- ❖ Fraud risks (opportunities, incentives, and rationale) identified as a result of performing risk assessment procedures;
- ❖ Susceptibility of certain cost statement balances and transactions to fraud;
- ❖ Any known instances of actual fraud in the past or in the current period; and
- ❖ Risks relating to management override

Related Requirements of *SCA-117 for* ***"The Cost Auditor's Response to Assessed Risks"***arereproduced below;

Para No	Related Requirements
5.3	***In designing the further audit procedures to be performed, the cost auditor shall:*** ***a) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each items of cost in***

Para No	Related Requirements
	the cost statement, and disclosure, including: *(i) The likelihood of material misstatement due to the particular characteristics of the relevant items of cost in the cost statement, or disclosure (that is, the inherent risk); and* *(ii) Whether the risk assessment takes account of relevant controls (that is, the control risk), thereby requiring the cost auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the cost auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and* *b) Obtain more persuasive audit evidence if the cost auditor's assessment of risk is higher.*
5.4	*The cost auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls if:* *a) The cost auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively(that is, the cost auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or* *b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.*
5.6	*In designing and performing tests of controls, the cost auditor shall:* *a) Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:* *(i) How the controls were applied at relevant times during the period under audit;* *(ii) The consistency with which they were applied; and* *(iii) By whom or by what means they were applied.* *b) Determine whether the controls to be tested depend upon other controls (indirect controls), and, if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls.*
5.8	*If the cost auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the cost auditor shall:* *a) Obtain audit evidence about significant changes to those controls*

Para No	Related Requirements
	subsequent to the interim period; and *b) Determine the additional audit evidence to be obtained for the remaining period.*
5.9	*In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the cost auditor shall consider the following:* *a) The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process;* *b) The risks arising from the characteristics of the control, including whether it is manual or automated;* *c) The effectiveness of general IT controls;* *d) The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control;* *e) Whether the lack of a change in a particular control poses a risk due to changing circumstances; and* *f) The risks of material misstatement and the extent of reliance on the control.*
5.14	*Irrespective of the assessed risks of material misstatement, the cost auditor shall design and perform substantive procedures for each material item of cost in the cost statement, and disclosure.*
5.16	*The cost auditor's substantive procedures shall include the following audit procedures related to the cost statement closing process:* *a) Agreeing or reconciling the cost statements with the underlying cost accounting records; and* *b) Examining material transactions and other adjustments made during the course of preparing the cost statements.*
5.20	*The cost auditor shall perform audit procedures to evaluate whether the overall presentation of the cost statements, including the related disclosures, is in accordance with the applicable cost reporting framework.*
5.21	*Based on the audit procedures performed and the audit evidence*

Para No	Related Requirements
	obtained, the cost auditor shall evaluate before the conclusion of the audit whether the assessments of the risks of material misstatement at the assertion level remain appropriate.
5.22	***The cost auditor shall conclude whether sufficient appropriate audit evidence has been obtained. In forming an opinion, the auditor shall consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the cost statements.***
5.23	***If the cost auditor has not obtained sufficient appropriate audit evidence as to a material cost statement assertion, the cost auditor shall attempt to obtain further audit evidence. If unable to obtain sufficient appropriate audit evidence, the cost auditor shall express a qualified opinion or disclaim an opinion on the cost statements.***
5.24	***The cost auditor shall include in the audit documentation:*** ***a) The overall responses to address the assessed risks of material misstatement at the cost statement level, and the nature, timing and extent of the further audit procedures performed;*** ***b) The linkage of those procedures with the assessed risks at the assertion level; and*** ***c) The results of the audit procedures, including the conclusions drawn where these are not otherwise clear.***

Appropriate audit approach for designing and performing further audit procedures depends upon the cost auditor's assessment of the identified risks at the assertion level. For example, the cost auditor may determine that:

a) Only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion;

b) Performing only substantive procedures is appropriate for particular assertions if the auditor's risk assessment procedures have not identified any effective controls relevant to the assertion, or because testing controls would be inefficient and therefore the auditor does not intend to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures; or

c) A combined approach using both tests of controls and substantive procedures is an effective approach.

The nature of an audit procedure refers to its purpose (that is, test of controls or substantive procedure) and its type (that is, inspection, observation, inquiry, confirmation, recalculation, re-performance, or analytical procedure). The nature of the audit procedures is of most importance in responding to the assessed risks. Timing of an audit procedure refers to when it is performed, or the period or date to which the audit evidence applies.

In addition, certain audit procedures can be performed only at or after the period end, for example:

a) Agreeing the cost statements to the cost records;

b) Examining adjustments made during the course of preparing the cost statements;

c) Reconciliation of profits, or in case of an entity carrying on any activity not for profit, of surplus, as per cost accounts and as per financial accounts;

d) Reconciliation of indirect taxes showing details of total clearance of goods/services, assessable value, duties/ taxes paid, CENVAT or VAT or Service Tax credit utilized, duties/taxes recovered and interest / penalty paid;

e) Statement of value addition and distribution of earnings.

When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.

13.10 TEST OF CONTROLS

Tests of controls are performed only on those controls that the cost auditor has determined are suitably designed to prevent, or detect and correct, a material misstatement in an assertion. If substantially different controls were used at different times during the period under audit, each is considered separately.

Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. However, the same types of audit procedures are used. The cost auditor may, therefore, decide it is efficient to test the operating effectiveness of controls at the same time as evaluating their design and determining that they have been implemented.

Although some risk assessment procedures may not have been specifically designed as tests of controls, they may nevertheless provide audit evidence about the operating effectiveness of the controls and, consequently, serve as tests of controls. For example, the cost auditor's risk assessment procedures may have included:

a) Inquiring about management's use of standards or budgets.

b) Observing management's comparison of monthly budgets or standards and actuals expenses & consumption quantities for items such as consumption of material, utilities, labour etc.

c) Inspecting reports pertaining to the investigation of variances between budgets/ standard and actual.

These audit procedures provide knowledge about the design of the entity's budgeting policies and whether they have been implemented, but may also provide audit evidence about the effectiveness of the operation of budgeting policies in preventing or detecting material misstatements in the classification of expenses.

In addition, the cost auditor may design a test of controls to be performed concurrently with a test of details on the same transaction. Although the purpose of test of controls is different from the purpose of test of details, both may be accomplished concurrently by performing test of controls and test of details on the same transaction, also known as a dual-purpose test. For example, the cost auditor may design and evaluate the results of a test to examine a material consumption to determine whether it has been approved and to provide substantive audit evidence of the consumption. A dual-purpose test is designed and evaluated by considering each purpose of the test separately.

When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control, as well as the degree of reliance on controls. Matters the cost auditor may consider in determining the extent of tests of controls include the following:

a) The frequency of the performance of the control by the entity during the period;

b) The length of time during the audit period that the cost auditor is relying on the operating effectiveness of the control;

c) The expected rate of deviation from a control;

d) The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level; and

e) The extent to which audit evidence is obtained from tests of other controls related to the assertion.

There is likely to be active management involvement in the cost reporting process that includes cost accounting-estimate preparation. As a result, controls over the estimating process may not exist, or, if they do exist, may operate informally. For this reason, the cost auditor's response to the assessed risks is likely to be substantive in nature, with the cost auditor performing one or more of the other responses outlined below.

To be addressed	Description
Have Estimates been prepared appropriately?	❖ Test how management made the cost accounting estimate and the data on which it is based. Evaluate whether: • The method of measurement used is appropriate in the circumstances, and • The assumptions used by management are reasonable in light of the measurement objectives of the applicable cost reporting framework. ❖ Test the operating effectiveness of the controls, if any, over how management made the cost accounting estimate, together with appropriate substantive procedures. ❖ Develop a point estimate or a range to evaluate management's point estimate. If the assumptions or methods used by the cost auditor differ from management's, obtain an understanding of management's assumptions or methods sufficient to establish that the cost auditor's point estimate or range takes into account relevant variables. Also evaluate any significant differences from management's point estimate. If it is appropriate to use a range, narrow the range, based on audit evidence available, until all outcomes within the range are considered reasonable.
How Reliable is the Supporting Evidence?	Undertake one or more of the following procedures, taking into account the nature of the accounting estimate, the nature of the evidence that will be obtained, and the assessed risk of material misstatement, including whether the assessed risk is a significant risk: Review events subsequent to the period end to ensure they support management's estimates. This may be particularly relevant in owner-managed entities, where management does not have formalized control procedures over cost accounting estimates. ❖ Test the information, controls (if any), methods, and

	assumptions used. ❖ Based on available evidence and discussions with management, develop an independent point cost estimate or range of reasonableness for comparison with the entity's cost estimate. The amount by which management's estimate differs from the point estimate or falls outside the range of reasonableness would be considered as a misstatement. ❖ The cost auditor's review of events in this period may be an effective response for cost accounting estimates other than fair value accounting estimates. If it is a longer period in finalizing the cost audit report.
Possible Management Bias	❖ Identify whether there are indicators of possible management bias. This could include changes in the way estimates are calculated, or the selection of a point estimate that indicates a pattern of optimism or pessimism. This could occur where estimates consistently lie at one boundary of the cost auditor's range of reasonableness, or where the bias moves from one boundary of the range to the other in successive periods. ❖ Consider the cumulative effect of bias in the preparation of management's cost accounting estimates.

13.11 ADEQUACY OF PRESENTATION AND DISCLOSURES

Evaluating the overall presentation and disclosure of the cost statements relates to whether the individual cost statements are presented in a manner that reflects the appropriate classification and description of cost information, and the form, arrangement, and content of the cost statements and their appended notes. This includes, for example, the terminology used, the classification of cost items in the statements, and the bases of cost allocation and apportionment set forth.

As the cost auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing or extent of other planned audit procedures. Information may come to the cost auditor's attention that differs significantly from the information on which the risk assessment was based. For example:

a) The extent of misstatements that the cost auditor detects by performing substantive procedures may alter the auditor's judgment about the risk assessments and may indicate a significant deficiency in internal control.

b) The auditor may become aware of discrepancies in cost records, or conflicting or missing evidence.

c) Analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognized risk of material misstatement.

In such circumstances, the cost auditor may need to re-evaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the classes of transactions, consumption norms, each material items of cost in the cost statement, or disclosures and related assertions.

The cost auditor cannot assume that an instance of fraud or error is an isolated occurrence. Therefore, the consideration of how the detection of a misstatement affects the assessed risks of material misstatement is important in determining whether the assessment remains appropriate.

The cost auditor's judgment as to what constitutes sufficient appropriate audit evidence is influenced by such factors as the following:

- Significance of the potential misstatement in the assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the cost statements.
- Effectiveness of management's responses and controls to address the risks.
- Results of cost audit procedures performed, including whether such audit procedures identified specific instances of fraud or error.
- Source and reliability of the available information.
- Persuasiveness of the audit evidence.
- Understanding of the entity and its environment, including the entity's internal controls.

13.12 DOCUMENTATION

The form and extent of audit documentation is a matter of professional judgment, and is influenced by the nature, size and complexity of the entity and its internal control, availability of information from the entity and the audit methodology and technology used in the audit.

For entities that have uncomplicated businesses and processes relevant to cost reporting, the documentation may be simple in form and relatively brief. It is not necessary to document the entirety of the cost auditor's understanding of the entity and matters related to it. Key elements of understanding documented by the cost auditor include those on which the auditor based the assessment of the risks of material misstatement.

"Risk is like fire: if controlled it will help you,
If uncontrolled it will rise up and destroy you"

By Theodore Roosevelt

CHAPTER -14 RELATED PARTIES

14.1 INTRODUCTION

Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the cost statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the cost statements than transactions with unrelated parties. For example:

(i) Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.

(ii) Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.

(iii) Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Management is responsible for the identification and disclosure of related parties and accounting as well record for the transactions. This responsibility requires management to implement adequate internal control to ensure that transactions with related parties are appropriately identified and recorded in the information system, anddisclosed in the cost statements.

Planning

- Identify related parties, including changes from previous periods.
- Understand nature, extent, and purpose of transactions
- Consider potential for fraud.
- Remain alert for related-party transactions throughout audit
- Consider significant risks

Performing

- Do any circumstances identified by the auditor suggest involvement of related parties?
- Obtain evidence to support management's assertions about the nature, extent, and purpose of transactions
- If outside normal course of business,consider significance of transactions.
- Consider measurement and

Reporting

- Has sufficient appropriate evidence been obtained?
- Does a material misstatement exist?
- Is cost statement disclosure adequate?
- Obtain management representations.
- Report on any findings

14.2 COST REPORTING FRAMEWORK IN CONTEXT OF RELATED PARTIES

As related parties are not independent of each other, there are often higher risks of material misstatement through related-party transactions than through transactions with unrelated parties. Consequently, cost reporting frameworks often contain accounting and disclosure requirements regarding related-party transactions and balances. These requirements are intended to provide cost statement users with an understanding of the nature of these transactions/balances and the actual or potential effects on cost statements

Where the applicable cost reporting framework establishes such requirements, the cost auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the cost reporting framework.

The applicable cost reporting framework establishes minimal or no related party requirements, the cost auditor nevertheless needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude the applicable cost reporting framework establishes minimal or no related party requirements, the cost auditor nevertheless needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude

(i) Achieve a true and fair presentation (true and fair presentation framework)

(ii) Are not misleading (for compliance framework)

The preparation of the cost statements requires management to substantiate an assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction. Management's support for the assertion may include:

(a) Comparing the terms of the related party transaction to those of an identical or similar transaction with one or more unrelated parties.

(b) Comparing the terms of the transaction to known market terms for broadly similar transactions on an open market.

Evaluating management's support for this assertion may involve one or more of the following:

(a) Considering the appropriateness of management's process for supporting the assertion.

(b) Verifying the source of the internal or external data supporting the assertion, and testing the data to determine their accuracy, completeness and relevance.

(c) Evaluating the reasonableness of any significant assumptions on which the assertion is based.

Some cost reporting frameworks require the disclosure of related party transactions not conducted on terms equivalent to those prevailing in arm's length transactions. In these circumstances, if management has not disclosed a related party transaction in the cost statements, there may be an implicit assertion that the transaction was conducted on terms equivalent to those prevailing in an arm's length transaction.

When information is identified that suggests the existence of related-party relationships or transactions that were not previously identified or disclosed by management, the cost auditor is required to determine whether the underlying circumstances confirm the existence of such relationships or transactions.

SCA -119 provides guidance on the cost auditor's responsibility and audit procedures regarding related parties and transactions with such parties.

Relevant Definitions of SCA-119 "Related Parties"

Arm's length transaction – A transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and reacting independently of each other and pursuing their own best interest.

Related party – A party that is either:

(i) A related party as defined in the applicable law and regulations;

(ii) A related party as defined in the applicable cost reporting framework; or

(iii) Where the applicable cost reporting framework establishes minimal or no related party requirements;

(a) A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;

(b) Another entity over which the reporting entity has control/ voting power or significant influence, directly or indirectly through one or more intermediaries; or

(c) Another entity that is under common control with the reporting entity through having:

1. Common controlling ownership;

2. Owners who are close family members; or

3. Common key management.

Many cost reporting frameworks discuss the concepts of control and significant influence. Although they may discuss these concepts using different terms, they generally explain that:

(a) Control is the power to govern the operating policies of an entity so as to obtain benefits from its activities; and

(b) Significant influence (which may be gained by share ownership, statute or agreement) is the power to participate in the operating policy decisions of an entity, but is not control over those policies.

The existence of the following relationships may indicate the presence of control or significant influence:

(a) Direct or indirect equity holdings or other financial interests in the entity.

(b) The entity's holdings of direct or indirect equity or other financial interests in other entities.

(c) Being part of those charged with governance or key management (that is, those members of management who have the authority and responsibility for planning, directing and controlling the activities of the entity).

(d) Being a close family member of any person referred to in subparagraph (c), and

(e) Having a significant business relationship with any person referred to in sub-para. (c).

Related parties, by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management. Consideration of such behaviour is relevant when identifying and assessing the risks of material misstatement due to fraud

Relevant related party information that may be shared among the Audit team members includes, for example:

a) The identity of the entity's related parties;

b) The nature of the related party relationships and transactions; and

c) Significant or complex related party relationships or transactions that may require special audit consideration, in particular transactions in which management or those charged with governance are involved.

The cost auditor is responsible for maintaining alertness for related-party information when reviewing records or documents during the audit. This includes the inspection of certain key documents, but does not require an extensive investigation of records and documents to specifically identify related parties.

Responsibility Where	Description
Applicable Cost Reporting Framework Establish Minimal or No Requirements	Obtain an understanding of the entity's related party relationship and transactions sufficient to: ▪ Recognize fraud risk factor, if any, arising from related party relationships and transactions that are relevant to the identifications and assessment of the risk of material misstatements due to fraud; and ▪ Conclude, based on the audit evidence obtained, whether cost statements, insofar as they are affected by those relationship, achieve fair presentation (for fair presentation frameworks); or are not misleading (for compliance framework).
Applicable Cost Reporting Frameworks set out the requirements	In addition to these steps described above, obtain sufficient appropriate audit evidence to comply with the specific accounting and disclosures requirement for related party relationship, transactions and balance.

To identify and assess the risk of Material Misstatement associated with related party relationship and transactions, the cost auditor would consider the matter set out below:

Identifying Risks	Description
Address Existence / Nature / Impact of Related Parties and transactions	Inquire about the; ▪ Identity of related parties, including changes from prior period. ▪ Nature of relationships between the entity and related parties. ▪ Type and purpose of any transactions with related parties. ▪ Controls, if any, that management has established to: ▪ Identify, account for, and disclose related-party relationships and transactions in accordance with the applicable cost reporting framework; ▪ Authorize and approve significant transactions and arrangements with related parties; and ▪ Authorize and approve significant transactions and arrangements outside the normal course of business.
Consider PossibleFraud	Discuss among the engagement team the susceptibility of cost statements to material misstatement due to fraud or error

Identifying Risks	Description
	resulting from related-party relationships and transactions. Also consider whether domination of management occurs by a single person or a small group of persons without compensating controls. Indicators of dominant influence include: ▪ The related-party has vetoed significant business decisions made by management or those charged with governance; ▪ Significant transactions are referred to the related-party for final approval; ▪ There is little or no debate among management and those charged with governance regarding business proposals initiated by the related-party; and ▪ Transactions involving the related-party (or a close family member of the related-party) are rarely independently reviewed and approved. Dominant influence may also exist in some cases if the related-party has played a leading role in founding the entity and continues to play a leading role in managing the entity. If fraud risk factors are identified, make an assessment of the risks of material misstatement. If a risk of material misstatement could occur, develop an appropriate audit response.
Remain Alert when Inspecting Records or Documents	When inspecting records or documents, always remain alert to undisclosed related party relationships or transactions. In particular, inspect the following records and documents for related parties not previously identified or disclosed: ▪ Participation in unincorporated partnerships with other parties ▪ Agreement for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business ▪ Guarantees and guarantor relationships
Identify Significant Risks	Significant related-party transactions outside the normal course of business would give rise to significant risks.

An arrangement involves a formal or informal agreement between the entity and one or more other parties for such purposes as:

a) The establishment of a business relationship through appropriate vehicles or structures;
b) The conduct of certain types of transactions under specific terms and conditions;
c) The provision of designated services or support.

Examples of transactions outside the entity's normal course of business may include;

a) The leasing of plant facilities or the rendering of management services by the entity to another party if no consideration is exchanged.
b) Sales transactions with unusually large discounts or returns.
c) Transactions with circular arrangements, for example, sales with a commitment to repurchase.
d) Transactions under contracts whose terms are changed before expiry.

In presence of other risk factors, the existence of a related party with dominant influence may indicate significant risks of material misstatement due to fraud. For example:

a) An unusually high turnover of senior management or professional advisors may suggest unethical or fraudulent business practices that serve the related party's purposes.

b) The use of business intermediaries for significant transactions for which there appears to be no clear business justification may suggest that the related party could have an interest in such transactions through control of such intermediaries for fraudulent purposes.

c) Evidence of the related party's excessive participation in or preoccupation with the selection of cost accounting policies or the determination of significant cost estimates may suggest the possibility of fraudulent cost reporting.

Relevant Requirements of SCA-119 ***"Related Parties"*** *are to obtain an understanding of related party relationships and obtain sufficient appropriate evidence about whether such transactions have been appropriately identified, accounted and disclosed in the cost statements are reproduced below:*

Para	Description
5.1	***Perform audit procedures relevant to identifying the risks of material misstatement associated with related parties alongwith risk assessment and audit procedures required to perform in other SCAs.***

Para	Description
5.3	***The cost auditor shall inquire of management regarding:*** ***(a) The identity of the entity's related parties, including changes from the prior period;*** ***(b) The nature of the relationships between the entity and these related parties; and*** ***(c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and business purpose of the transactions.***
5.4	***The cost auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to:*** ***(a) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable cost reporting framework;*** ***(b) Authorize and approve significant transactions and arrangements with related parties; and*** ***(c) Authorize and approve significant transactions and arrangements outside the normal course of business.***
5.5	***During the audit, the cost auditor shall remain alert, when inspecting cost records and other related documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the cost auditor.***
5.6	***In particular, the cost auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the cost auditor:*** ***(a) Third party confirmations obtained as a part of auditor's procedures;*** ***(b) Minutes of meetings of shareholders/ Board of Directors/ Committees and of those charged with governance; and*** ***(c) Such other records or documents as the cost auditor considers necessary in the circumstances of the entity.***
5.7	***If the cost auditor identifies significant transactions outside the entity's normal course of business when performing the audit procedures required or through other audit procedures, the cost***

Para	Description
	auditor shall inquire of management about: ***(a) The nature of these transactions; and*** ***(b) Whether related parties could be involved.***
5.9	***The cost auditor shall identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks. In making this determination, the cost auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks.***
5.11	***As part of the SCAs requirement that the cost auditor respond to assessed risks, the cost auditor designs and performs further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions.***
5.12	***If the cost auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the cost auditor, the cost auditor shall determine whether the underlying circumstances confirm the existence of those relationships or transactions.***
5.13	***If the cost auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the cost auditor, the cost auditor shall:*** ***(a) Promptly communicate the relevant information to the other members of the audit team;*** ***(b) Where the applicable cost reporting framework establishes related party requirements:*** ***(i) Request management to identify all transactions with the newly identified related parties for the cost auditor's further evaluation; and*** ***(ii) Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;*** ***(c) Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions;***

Para	Description
	(d) Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the cost auditor, and perform additional audit procedures as necessary; and *(e) If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit.*
5.14	*For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the cost auditor's understanding of the entity and its environment and other information obtained during the cost audit, the cost auditor shall evaluate;* *(a) Inspect the underlying contracts or agreements, if any, and evaluate whether:* *(i) The business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent cost reporting or under valuation of transactions.* *(ii) The terms of the transactions are consistent with management's explanations; and* *(iii) The transactions have been appropriately accounted for and disclosed in accordance with the applicable cost reporting framework; and* *(b) Obtain audit evidence that the transactions have beenappropriately authorized and approved.*
5.15	*If management has made an assertion in the cost statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the cost auditor shall obtain sufficient appropriate audit evidence about the assertion.*
5.16	*In forming an opinion on the cost statements in accordance with SCAs the cost auditor shall evaluate:* *(a) Whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable cost reporting framework; and* *(b) Whether the effects of the related party relationships and transactions:* *(i) Prevent the cost statements from achieving true & fair*

Para	Description
	presentation (for true and fair presentation frameworks); or ***(ii) Cause the cost statements to be misleading (for compliance frameworks).***
5.17	***Where the applicable cost reporting framework establishes related party requirements, the cost auditor shall obtain written representations from management and, where appropriate, those charged with governance that:*** ***(a) They have disclosed to the cost auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and*** ***(b) They have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.***
5.18	***Unless all of those charged with governance are involved in managing the entity, the cost auditor shall communicate with those charged with governance significant matters arising during the audit in connection with the entity's related parties***
5.19	***The cost auditor shall include in the cost audit documentation:*** ***(a) The names of the identified related parties and the nature of the related party relationships and transactions;*** ***(b) The nature and extent of the audit procedures performed to comply with applicable legal and regulatory requirements.***

In responding and reporting to the identified risks of material misstatements associated with related party relationship and transactions

Para	Description
Where cost auditor identifies arrangements or information that suggests existences of Related Party Relationship or Transactions	• Determine whether underlying circumstances confirm their existence; • Promptly communicate the information to the engagement team; • Request management to identify all transactions with the related-party; • If related-party was not previously identified, ask why. Consider: - Failure of any related-party identification

Para	Description
	controls, and - Fraud (non-disclosure by management appears intentional); • Reconsider the risk that other undisclosed related parties or significant related-party transactions may exist, and perform additional audit procedures as necessary; and • Perform appropriate substantive audit procedures.
Significant Related Party Transactions outside	• Inspect underlying contracts or agreements, if any, and evaluate whether: - Rationale suggests possible fraudulent cost reporting or concealment of misappropriated assets, - Terms are consistent with management's explanations, and - Transactions are accounted for and disclosed in accordance with the applicable cost reporting framework; and • Ensure transactions have been appropriately authorized and approved.
Management's Assertions	• Obtain sufficient appropriate audit evidence about management's assertions about the nature and extent of related-party transactions. • Consider the collectability and valuation of period-end balances.
Document and Report	• Document the names of the identified related parties and the nature of the related-party relationships; and • Communicate with those charged with governance any significant matters arising during the audit in connection with related parties.
ObtainManagementRepresentation	• Obtain written representation from management (and those charges with governance)

Para	Description
	• Such relationship and transactions have been appropriately accounted for and disclosed in the cost statements
Determine if the Audit Opinion needs to be Modified	Modify the cost auditor's report if: ▪ It is not possible to obtain sufficient appropriate audit evidence concerning related parties and transactions; or ▪ Managements' disclosure in the cost statements (as required by the cost statement framework) is not considered.

In evaluating the business rationale of significant related party transactions outside the entity's normal course of business, the cost auditor may consider the following:

(a) Whether the transaction:

(i) is overly complex (for example, it may involve multiple related parties within a consolidated group);

(ii) has unusual terms of trade, such as unusual prices, interest rates, payment terms;

(iii) lacks an apparent logical business reason for its occurrence;

(iv) involves previously unidentified related parties; or

(v) is processed in an unusual manner.

(b) Whether management has discussed the nature of, and accounting for, such a transaction with those charged with governance.

(c) Whether management is placing more emphasis on a particular cost accounting treatment rather than giving due regard to the underlying economics of the transaction.

(d) If management's explanations are materially inconsistent with the terms of the related party transaction, the cost auditor is required, in accordance with SCAs to consider the reliability of management's explanations and representations on other significant matters.

Cost Reporting Framework	Fair presentation Framework	Compliance Framework
Cost Reporting Framework	In the context of a true and	In the context of a compliance

Cost Reporting Framework	Fair presentation Framework	Compliance Framework
that establishes minimal related party requirements is one that defines the meaning of a related party but that definition has a substantially narrower scope than the definition set out in law and regulations, so that a requirement in the framework to disclose related party relationships and transactions would apply to substantially fewer related party relationships and transactions. The cost auditor is required to disclose all the substantial transactions set out in law and regulation	fair presentation framework, related party relationships and transactions may cause the cost statements to fail to achieve true and fair presentation if, for example, the economic reality of such relationships and transactions is not appropriately reflected in the cost statements. For instance, value of purchase and sale of raw materials, finished goods, rendering of services, utilization of plant services and technical know-how may not be achieved if these transactions with related parties are not at arm's length price.	framework, whether related party relationships and transactions cause the cost statements to be misleading as discussed in SCAs depends upon the particular circumstances of the audit engagement. For example, even if non-disclosure of related party transactions in the cost statements is in compliance with the framework and applicable law or regulation, the cost statements could be misleading if the entity derives a very substantial portion of its revenue from transactions with related parties, and that fact is not disclosed. However, it will be extremely rare for the cost auditor to consider cost statements that are prepared and presented in accordance with a compliance framework.

14.3 RECORDS OR DOCUMENTS THAT THE COST AUDITOR MAY INSPECT

During the cost audit, the Cost Auditor may inspect records or documents that mayprovide information about related party relationships and transactions, for example:

a) Third-party confirmations obtained by the cost auditor
b) Entity indirect tax returns
c) Information supplied by the entity to regulatory authorities
d) Statements of conflicts of interest from management and those charged with governance
e) Contracts and agreements with key management or those charged with governance

f) Significant contracts and agreements not in the entity's normal course of business
g) Specific invoice and correspondence from the entity's professional advice
h) Significant contracts re-negotiated by entity during the period
i) Internal Auditor' s report
j) Documents associated with the entity's filing with a regulators

It is not who is right but what is right that is important.

....By Thomas Huxley

CHAPTER -15 AUDIT EVIDENCE

Audit evidence is necessary to support the cost auditor's opinion and cost audit report. It is cumulative in nature and is primarily obtained from cost audit procedures performed during the course of the cost audit. It may, however, also include information obtained from other sources such as previous cost audits (provided the cost auditor has determined whether changes have occurred since the previous cost audit that may affect its relevance to the current cost audit). In addition to other sources inside and outside the entity, the entity's cost records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert.

Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the cost auditor, and therefore, also constitutes audit evidence.

In the conduct of an engagement, the engagement team should obtain sufficientappropriate audit evidence to enable it to draw reasonable conclusions on which to basethe audit opinion. The engagement team is not expected to address all information thatmay exist as they may use sampling approaches and other means of selecting items fortesting. The team may find it necessary to rely on evidence that is persuasive rather thanconclusive.

Audit evidence should be evaluated by its characteristics which include:

- Sufficiency
- Appropriateness

Audit Evidence:Information used by the cost auditor in arriving at the conclusions on which the cost auditor's opinion is based. Audit evidence includes both information contained in the cost accounting records underlying the cost statements and all other related information.

Appropriateness (of audit evidence): The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the cost auditor's opinion is based.

Sufficiency (of audit evidence): The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the cost auditor's assessment of the risk of material misstatement and also by the quality of such audit evidence.

15.1 SUFFICIENT AND APPROPRIATE EVIDENCE

Sufficiency is the measure of the quantity of audit evidence, whereas appropriateness is the measure of the quality of audit evidence. The quantity of audit evidence needed is affected by cost auditor's assessment of the risk of material misstatement and also the quality of such evidence (the higher the quality, the less evidence may be required). Obtaining more audit evidence, however, may not compensate for its quality. The relevance and reliability in providing support for the conclusions on which the cost auditor's opinion shall be based on appropriateness. The cost auditor shall obtain sufficient appropriate audit evidences which are closely interrelated.

The judgement on what is sufficient will be influenced by:

- The risk of misstatement (the greater the risk, the more evidence is likely to be required);
- The assessment of the cost accounting records and internal control procedures;
- The materiality of the item being examined;
- The experience gained during previous audits; and
- The source and nature of the evidence available.

The appropriateness of the audit evidence is determined by its quality and relates to:

- Relevance
- Reliability

15.1.1 Relevance

Relevance of audit evidence refers to its relationship to the assertion or to the objective of the control being tested. The relevance of audit evidence depends on:

a) The design of the audit procedure used to test the assertion or control, in particular whether it is designed to:

   - Test the assertion or control directly; or
   - Test for understatement or overstatement.

ii. The timing of the cost audit procedure used to test the assertion or control.

Relevance deals with the logical connection with, or bearing upon, the purpose of the cost audit procedure and, where appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction of testing.

For example, if the purpose of cost audit procedure is to test for overstatement or understatement in valuation of finished goods inventory, testing the records of production and sales (including physical dispatches) may be a relevant audit procedure. In addition testing records relating to subsequent production, work-in-progress, consumption statements, and utilities consumption reports may be relevant. However, a given set of cost audit procedures may provide audit evidence that is relevant to certain assertions, but not others.

Audit evidence obtained from previous cost audits may provide audit evidence where the cost auditor performs audit procedures to establish its continuing relevance. For example, in performing a previous cost audit, the cost auditor may have determined that an automated control for material consumption was functioning as intended. The cost auditor may obtain audit evidence to determine whether any changes to the automated control for material consumption have been made that may affect its continued effective functioning.

15.1.2 Reliability

The reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained. Some audit evidence is obtained by performing cost audit procedures to test the cost records, for example, through analysis and review, re-performing procedure followed in the cost reporting framework, and reconciling related types and applications of the same information. Through the performance of such cost audit procedures, the cost auditor may determine that the cost records are internally consistent, reconciled, and agree to the financial statements.

Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.

For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity. While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence may be useful:

a. The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.

b. The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.

c. Audit evidence obtained directly by the cost auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

d. Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporary written record of internal report is more reliable than an oral representation of the matters discussed).

e. Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance of those documents.

More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually. For example, corroborating information obtained from a source independent of the entity may increase the assurance the cost auditor obtains from audit evidence that is generated internally, such as analysts' report, input-output norms, comparable data about competitors (benchmarking data), confirmation from third party, etc.

To summarize, when assessing the reliability of audit evidence the engagement team should considerthe following factors:

- External evidence (e.g. independent third party confirmations or from an examination of external documents) is more reliable than internal evidence.
- Internally generated information is more reliable when related controls imposed by the entity are effective.
- Documentary evidence whether paper, electronic or other medium, is more reliable than oral evidence.
- Evidence obtained directly by the firm (such as observation of the application of a control or physical inspection) is more reliable than audit evidence obtained indirectly or by inference.
- Internal evidence may be more reliable if it is obtained:
    - From a reliable senior official
    - From an employee with no financial interest in the entity; or
    - From a number of different personnel
- Original documents are more reliable than copies.

*Relevant Requirements of SCA-107**"Audit Evidence"**is to enable the cost auditor to design and perform cost audit procedure in such a way to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusion on which cost auditor's opinion is based are reproduced below:*

Para	Description
5.2	***The cost auditor shall consider the relevance and reliability of the information to be used as audit evidence when designing and performing cost audit procedures.***
5.3	***If information to be used as audit evidence has been prepared using the work of a management's expert, the cost auditor may, to the extent necessary, having regard to the significance of that expert's work for the cost auditor's purposes:*** ***(a) Evaluate the competence, capabilities and objectivity of that expert;*** ***(b) Obtain an understanding of work of that expert; and*** ***(c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.***
5.4	***The cost auditor shall evaluate whether the information is sufficiently reliable for the audit purpose, including, as necessary in the circumstances:*** ***(a) Obtaining audit evidence about the accuracy and completeness of the information; and*** ***(b) Evaluating whether the information is sufficiently precise or detailed for the cost auditor's purposes.***
5.5	***The cost auditor shall determine means of selecting items for testing that are effective in meeting the purpose of cost audit procedures, when designing tests of controls and tests of details for obtaining audit evidence.***
5.6	***The cost auditor shall determine extent of modification or addition to cost audit procedures that are necessary to resolve the matter and shall also consider the effect of matter, if any, on the other aspects of cost audit, if:*** ***(a) audit evidence obtained from one source is inconsistent with that obtained from another; or*** ***(b) the cost auditor has doubts over the reliability of information to be used as audit evidence.***

The cost auditor shall apply cost audit procedures to obtain and evaluate audit evidence in forming the opinion. Such cost audit procedures can include inquiry, inspection, observation, recalculation, re-performance and analytical procedures, often in some combination.

15.2 AUDIT PROCEDURES FOR OBTAINING AUDIT EVIDENCE

Audit evidence to draw reasonable conclusions that is used by the cost auditor to form his opinion, is obtained by performing:

(i) Risk assessment procedures; and
(ii) Further cost audit procedures, which comprise:

(a) Test of Controls,
(b) Substantive Procedures, including
(c) Tests of Details, and
(d) Substantive Analytical Procedures

The cost audit procedures outlined below may be used as risk assessment procedures, tests of controls or substantive procedures, depending on the context on which they are applied by the cost auditor.

→ Inspection
→ Observation
→ External Confirmation
→ Recalculation
→ Re-Performance
→ Analytical Procedures
→ Inquiry

(The above mentioned audit procedures are explained in detail in Chapter – "Audit Procedures" of this guide)

15.3 USE OF WORK OF MANAGEMENT EXPERTS

The preparation of entity's cost statement may require expertise in a field other than accounting or auditing, such as engineering data.The entity may employ or engage experts in these fields to obtain the needed expertise to prepare the cost statements. Failure to do so when such expertise is necessary increases the risks of material misstatement.

Considerations when evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion may include:

(a) The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the cost statements;

(b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and

(c) If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data

15.4 SELECTING ITEMS FOR TESTING TO OBTAIN AUDIT EVIDENCE

An effective test provides appropriate audit evidence to an extent that, taken with other audit evidence obtained or to be obtained, will be sufficient for the cost auditor's purposes. The means available to the cost auditor for selecting items for testing are:

1) Selecting all items (100% examination);
2) Selecting specific items; and
3) Audit sampling.

The application of any one or combination of these means may be appropriate depending on the particulars circumstances.

15.4.1 Selecting All Items (100% Examination)

The cost auditor may decide that it will be most appropriate to examine the entire population of items that make up significant items of cost (or a stratum within that population). Hundred percentexamination is unlikely in the case of tests of controls; however, it is more common for tests of details. Hundred percent examination may be appropriate when:

(a) The population constitutes a small number of large value items;

(b) There is a significant risk and other means do not provide sufficient appropriate audit evidence; or

(c) The repetitive nature of a calculation or other process performed automatically by an information system makes a 100% examination cost effective.

15.4.2 Selecting Specific Items

In making this decision, factors that may be relevant include the cost auditor's understanding of the entity, the assessed risks of material misstatement, and the characteristics of the population being tested. The judgmental selection of specific cost items is subject to non-sampling risk. Specific cost items selected may include:

(a) High value or key cost item (for example, cost items that are suspicious, unusual, and particularly risk prone or that have a history of error)

(b) All the cost item that have certain amount (for example, recorded value exceed a certain amount so as to verify a large proportion of the total amount of the items of cost)

(c) Cost items to obtain information's (for example, obtain information about matter such as the nature of transactions or cost heads)

15.4.3 Audit Sampling

Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it.

Note:

This topic is discussed in detail in chapter – "Audit Sampling" of this guide.

15.4.4 Evaluation of Audit Evidence

The goal for the cost auditor is to be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached, and for an appropriately worded cost auditor's report to be issued. After the planned audit procedures have been performed, an evaluation of the results will take place.

What constitutes sufficient appropriate audit evidence is ultimately a matter of professional judgment. It will be primarily based on the satisfactory performance of audit procedures designed to address the assessed risks of material misstatement. This includes any additional or modified procedures that were performed to address changes identified in the original assessment of risk. Some of the factors to consider in evaluating the sufficiency and appropriateness of audit evidence include the factors outlined in below.

a) **Materiality of Misstatement:**How significant is a misstatement in the assertion being addressed, and what is the likelihood of it having a material effect (individually or aggregated with other potential misstatements) on the cost statement?

b) **Management Responses:**How responsive is management in audit finding, and how effective is the internal control in addressing risk factors?

c) **Previous Experience:**Whathas been the previous experience in performing the similar procedures, and where any misstatements identified?

d) **Results of Performed Audit Procedures:**Do the results performed audit procedures support the objectives, and are there any indication of fraud or error?

e) **Quality of Information:** Are the source and reliability of the available information appropriate for supporting audit conclusion?

f) **Persuasiveness:** How persuasive (convincing) is the audit evidence?

g) **Understanding the Entity:**Does the evidence obtained support or contradict the results of the risk assessment procedures (which were performed to obtain an understanding of entity and its environment, including internal control)?

The evaluation of the audit evidence obtained would address the matter set out below.

Points to Consider	Description
Materiality	Are the amounts established for overall and performance materiality still appropriate in the context of the entity's actual results? If a lower overall materiality (for the cost statements as a whole) than that initially determined is appropriate, the cost auditor is required to determine: → Whether it is necessary to revise performance materiality; and → Whether the nature timing and extent of the further audit procedures remain appropriate.
Risk	In light of the audit findings, are assessments of risks of material misstatement at the assertion level still appropriate? If not, the risk assessments would be revised and further planned audit procedures modified.
Misstatements	Has the effect on the audit of identified misstatements and uncorrected misstatements been considered? Has the reason for misstatements/deviations been considered? They may indicate an unidentified risk or a significant deficiency in internal control. Does the overall audit strategy and audit plan need to be revised? This would apply when: ♦ The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or ♦ The aggregate of misstatements accumulated during the audit approaches materiality. Have additional audit procedures been performed to determine whether misstatements remain (in items of cost, cost heads, classes of transactions, account balance, or disclosures) where management was asked to correct misstatements?
Fraud	Does information obtained from performing other risk assessment procedures and related activities indicate that one or more fraud risk factors are present? Did the analytical procedures performed near the end of the audit indicate a previously unrecognized risk of material

Points to Consider	Description
	misstatement due to fraud? Have identified misstatements been evaluated to determine whether such a misstatement is indicative of fraud? If so, evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations. An instance of fraud is unlikely to be an isolated occurrence. Is there any reason to believe that management could be involved in the identified misstatements whether material or not, as a result of fraud? If so, re-evaluate the assessment of the risks of material misstatement due to fraud and its resulting impact on the nature, timing and extent of audit procedures to respond to the assessed risks. Also consider whether circumstances or conditions indicate possible collusion involving employees, management, or third parties when reconsidering the reliability of evidence previously obtained. If fraud risks have been identified, it is possible to confirm that the cost statements are not materially misstated as a result of fraud. If not possible, determine the implications for the audit, including whether it brings into question the ability to continue performing the audit.
Evidence	Has sufficient appropriate evidence been obtained to reduce the risks of material misstatement in the cost statements to an acceptably low level? Consider the need for further procedures to be performed.
Analytical Procedures	Did the analytical procedures performed at the final review stage of the audit: ➢ Corroborate the audit findings; or ➢ Identify previously unrecognized risks of material misstatement?

The assessment of risk at the assertion level will often be based on audit evidence available before performing further audit procedures. During the time these procedures are being performed, new information may be obtained that will require the original risk assessment to be modified.

Some points to consider in determining whether the original assessment of risk has changed or not are outlined below

Point to Consider	Description
Internal Control	**Test of Controls** ▪ Do the results of performing tests if control support the planned level of risk reduction based on their operating effectiveness? **Management Override** ▪ Is there any evidence of management override of existing internal control? **Control Deficiencies** ▪ Does a potential misstatement(s) result form a deficiency in internal control that should be immediately brought to management's attention?
Nature of Audit Evidence Obtained	**New Risk Factors** ▪ Does the evidence identify any new business risk, fraud risk factors, or management override? **Contradictory Evidence** ▪ Does the evidence obtained contradict other sources of information available? **Conflicting Evidence** ▪ Does the evidence obtained conflict with current understanding of entity? **Cost Accounting Policies** ▪ Isthere any evidencethatentity's cost accounting policies are not always consistently applied? **Unpredictable Relationships** ▪ Does the evidence substantiate the relationship among cost and non cost items or data, financial and non- financial data? **Fraud** ▪ Is there evidence of any patterns, oddities, exception, or deviation found in performing tests that could be indicative of possible fraud (including management override) occurring? **Reliability of Representations** ▪ Is there evidence that questions the reliability of representations made by management or those charged

Point to Consider	Description
	with governance?
Nature of Misstatements	**Bias in Estimates** ▪ Could misstatements found in cost accounting estimates, classification of cost, cost ascertainment, cost measurement, cost allocation or appropriation or absorption of cost or valuation or fair valuation measurements indicate possible pattern of bias by management? **Misstatements** ▪ Do misstatements, either individually or combined with all other uncorrected misstatements, constitute a material misstatement in the cost statements taken as whole?

Where the original assessment of risk has changed, the details should be documented and a revised assessment of risk determined to perform further audit procedures for obtaining new or revised audit evidences to address the risk of material misstatements either due to error or fraud.

There should also be details of how the detailed audit plan has been changed to address the revised risk assessment. This may be a modification to the nature, timing, or extent of other planned audit procedures or performance of further audit procedures.

15.4.5 Inconsistency in, or Doubts Over Reliability of Audit Evidence

If audit evidence obtained from one source is inconsistent with that obtained from another, or if the cost auditor has doubts about the reliability of information to be used as audit evidence, the cost audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit of cost statements.

I am sceptical about everything except reality

By Henry Mintzberg

CHAPTER -16 EVALUATION OF MISSTATEMENT

The purpose of evaluating misstatements is to determine the effect on the audit and whether there is need to perform additional / further audit procedures

Revisions to the audit strategy and detailed audit plan may be required when;

- *The nature or circumstances of identified misstatements indicate that other misstatements(s) may exist that, when aggregated with known misstatements, could exceed performance materiality; or*
- *The aggregate of identified and uncorrected misstatements comes close to or exceeds performance materiality.*

SCA – 111 deals with the ***"Cost auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the cost statements".***

Misstatement: A difference between the amounts, classification, presentation or disclosure of a reported cost statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable cost reporting framework. Misstatement can arise from error or fraud.

Where the cost auditor expresses an opinion on whether the cost statements give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the cost auditor's judgement, are necessary for the cost statements to be presented fairly, in all material respects, or to give a true and fair view.

Misstatement may result from:

(a) An inaccuracy in gathering, classifying and/or processing data from which the cost statements are prepared;

(b) An omission;

(c) An incorrect cost estimate arising from overlooking, or clear misrepresentation of, facts; and

(d) Judgements of management on cost estimates that the cost auditor considers unreasonable or the selection and application of costing principles, method, and policies that the cost auditor consider inappropriate.

Uncorrected Misstatements: Misstatements that cost auditor has accumulated during the audit and that have not been corrected.

SCA-111 is to assist the cost auditor in evaluating the misstatements identified during the audit. The Standard requires cost auditor to assess whether an individual misstatement or aggregate of misstatements approaches materiality; if so, communicate the same with management for appropriate correction; evaluate the effect of uncorrected misstatements; communicate with those charged with governance; and appropriately document the conclusions and the basis for arriving at the conclusions.

In general term, a misstatement is the difference between:

- the size of a figure as shown in the cost statements or how it has been disclosed or presented and
- the size it should be if it had been properly calculated, or what its correct disclosure or presentation should be if the relevant cost accounting standards had been applied correctly.

Misstatements may result from:

- Inaccuracy in gathering, classifying, and /or processing data from which the cost statements are prepared. For example, items of cost incorrectly taken from the cost records and included in the cost statements or calculation error or simple mistakes in posting figures / cost heads classification of cost.
- Amounts or statutory disclosures omitted, for example failing to fully disclose related parties transactions.
- Incorrect cost estimates arising from misinterpreting facts or overlooking or clear misrepresentation of facts which is relevant to the calculation of the cost estimate, for example basis of calculating normal and abnormal losses.
- Estimates based on judgements which are clearly excessive or unreasonable in the circumstances. This includes the use of cost accounting principle, methods & policies which are unreasonable or inappropriate, for example revaluating plant equipment over useful years where it's useful life is considerably less that may lead to under absorption of depreciation amount in cost statements.

16.1 NATURE OF MISSTATEMENT

Misstatements may arise from a number of cause and can be on the following:

- Size – the monetary amount involved (quantitative);
- Nature of item (qualitative); and
- Circumstances surrounding the occurrence

16.1.1 Typical Misstatements

- Errors and fraud identified in the preparation of the cost statements;
- Departures from the applicable cost reporting framework;
- Fraud perpetrated by employees or management;

- Management error;
- Preparation of inaccurate or inappropriate cost estimates; or
- Inappropriate or incomplete descriptions of cost accounting policies or note disclosures.

16.2 AREAS OF MISSTATEMENTS IN COST STATEMENTS, EITHER DUE TO ERROR OR FRAUD

There is no literature that has given an exhasutive list of areas of mistatements in cost records and cost statements, arising either due to error or fraud. However, for the benefit of cost auditors, a tentative list of such areas is given below.

- Understatement or overstatement of installed capacties;
- Misstatement in measurement, classification, allocation, apportionment and absorption of costs;
- Misstatement of costs with a view to claim higher subsidies or evade taxes or due to error;
- Over-valuation or under-valuation of inventory either due to error or with a view to manipulate profits and taxes;
- Wrong consumption of raw materials, utilities and other inputs resulting in misstatement in cost of production;
- Misstatement in production and sales records to evade taxes;
- Wrongful recognition of revenues;
- Wrong classification of joint-products or by-products;
- Significant variations in physical inventories vis-a-vis stock statements;
- Non or wrong recognition of idle capacities, idle facilities, idle manpower, etc;
- Overstatement or understatement of scrap, defectives, wastages, spoilage, etc;
- Non-recognition of cases of thefts, pilfirage, etc., if any;
- Recognition of abnormal costs as normal costs or vice versa;
- Recognition of non-cost items as costs or vice versa;
- Inappropriate traceability of costs to particular cost objects;
- Misstatement in arm's length price in relation to transactions with related parties;
- Wrong certification of stocks lying with third parties;
- Over or under invoicing of purchases or sales;
- Recognition of fake bills of purchases of goods and services;
- Recognition of costs not actually incurred;

- Treatment of capital as revenue or vice-versa;
- Booking of fake manpower costs not actually engaged;
- Wrongful recognition of group companies' costs or assets;
- Recognition of dead or unserviceable stocks as 'good' inventories or vice versa;
- Recognition of third party stocks as own stocks or vice versa;
- Non-booking of costs already accrued;
- Mistatement in quantities and values showing material mismatch with cost estimates;
- Treatment of self-manufactured materials, components, sub-assemblies, tools, etc. as purchases;
- Valuation of international transactions at wrong forex rates;
- Wrongful recognition of subsidies, grants, incentives, etc;
- Recognition of imputed costs;
- Recognition of defectives production as good ones or vice versa;
- Recognition of semi-finished goods as finished goods or vice versa; or
- Under or overstating life of assets [or additions to or deletion of assets] resulting in over or undercharging of depreciation or amortization.

The objective of evaluating misstatement is to determine the effect on the audit of cost statement and whether there is need to perform additional audit procedures. Misstatement can arise in the area mentioned above due to multiple sources, either alone or in combination of other source.

Some of the illustrative sources are outlined below:

Source	Description
Inaccuracies or Fraud	Mistake may be made by the entity's personnel in gathering or processing data upon which the cost statements are prepared. This would also include errors made in cut off at the period end. In addition to identifying specific misstatements, the cost auditor may also: ♦ Quantify the mistakes in a particular population (such as consumption details) through monetary sampling. A likely aggregate of misstatements can be projected when a representative sample is used; and ♦ Consider the nature of identified misstatements. If there are numerous misstatements affecting a particular balance or business location, it may be indicative of a risk of

Source	Description
	material misstatement due to fraud. i.e BOM Cost
Omission or Fraud	Some transactions may not be recorded, either by mistake or deliberately, the latter of which would constitute fraud. i.e. credit of recoveries by sale of by- product
Significant Transactions	A lack of business rationale for significant transactions (unusual or outside the normalcourse of business) could be intended to manipulate the cost statements or toconceal misappropriation of assets i.e. written off obsolete inventory under the head "BOM Consumption"
Journal Entries	Inappropriate or unauthorized journal entries may have occurred throughout the period or at period end. These could be used to manipulate amount reported in the cost statements i.e. over absorption of overhead to product
Error in Cost Estimates	Management estimates may calculate incorrectly, overlook or misinterpret certainfacts, use faulty assumptions or contain some element of bias if the entity's estimatefalls outside an acceptable range. Estimates could also be deliberately misstated tomanipulate cost statement results i.e. assumptions for price escalation while making cost estimate for completion of construction contract.
Selection and application of Cost Accounting Policies	There may be disagreements with management with regard to the selection and useof certain cost accounting policies i.e. basis for absorption of overheads.
Uncorrected Misstatements	Uncorrected misstatements from prior periods would be reflected in opening equity.If not adjusted, they may also cause amisstatement in the current period financialstatements.
Treatment of Revenue	Overstatement or understatement of revenues (e.g. premature revenue recognition,recording fictitious revenues, or improperly shifting revenues to a later period).
Internal Control Weakness	Misstatements could result from unexpected deficiencies in internal control. Thesewould be discussed or reported to management, and consideration would be givento performing additional work to identify other misstatements that may exist. i.e. unauthorized change to Input-Output Standard norms, BOM structure in IT System
Cost Statement Presentation or	Certain cost statement disclosures required by the cost accounting framework may beomitted, incomplete, or inaccurate. i.e. capacity

Source	Description
Disclosures	determination or actual capacity utilization

To assist the cost auditor in evaluating the effect of misstatements and in communicating misstatements to management and those charged with governance, it may be useful to distinguish between factual misstatements, judgmental misstatements and projected misstatements:

(a) Factual misstatements are misstatements about which there is no doubt.

(b) Judgmental misstatements are differences arising from the judgments of management concerning cost estimates that the auditor considers unreasonable, or the selection or application of costing principles, methods, and policies that the cost auditor considers inappropriate.

(c) Projected misstatements are the auditor's estimate of misstatements in populations based on misstatements identified in audit samples of those entire populations. *Guidance on use of Audit Samplings to draw conclusion about the population is set out in SCA 106 –"Audit Sampling".*

The circumstances related to some misstatements may cause the cost auditor to evaluate them as material, individually or when considered together with other misstatements accumulated during the audit, even if they are lower than materiality for the cost statements as a whole. Circumstances that may affect the evaluation include the extent to which the misstatement:

- Affects compliance with regulatory or contractual requirements
- Relates to the incorrect selection or application of a cost accounting policy that has an immaterial effect on the current period's cost statements but is likely to have a material effect on future periods' cost statements
- Relates to allocation or apportionment of revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.
- Affects ratios used to evaluate productivity, profitability or performance of a cost object; [*cost object: an activity, contract, cost center, customer, product, process, project, service or any other object for which costs are ascertained - def., Cost Accounting Standards*].
- Relates to adjustments made during the course of preparing the cost statements for example transferring of cost from one production cost center to another.

- Relates to items involving particular parties (for example, whether external parties to the transaction are related to members of the entity's management).
- Affect users' expectations regarding the measurement of costs or disclosure of certain items of cost (for example, cost of production of goods captively consumed, related party transactions)

These circumstances are only examples, not all likely to be present in all situations and nor is the list exhaustive. The existence of any circumstances such as these does not necessarily lead to conclusion that the misstatement is material.

*Relevant Requirements of SCA-111**"Evaluation of Misstatement identified during the Cost Audit"**is to enable the cost auditor to evaluate; (a) The effect of misstatements identified during the cost audit; (b) The effect of uncorrected misstatements, if any, on the cost statements are reproduced below:*

Para	Description
5.1	***The cost auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial.***
5.2	***The cost auditor shall determine whether the overall audit strategy and audit plan need to be revised if:*** ***i. the nature of identified misstatements and circumstances of occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or*** ***ii.the aggregate of misstatements accumulated during audit approaches materiality.***
5.3	***The cost auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. The cost auditor shall request management to correct those misstatements.***
5.4	***If on the request of cost auditor, management has examined and corrected misstatements that were detected, the cost auditor shall perform additional audit procedures to determine whether misstatements remain.***
5.5	***If management refuses to correct some or all of the misstatements communicated by the cost auditor, the cost auditor shall obtain an understanding of management's reason for not making the corrections and shall take that understanding into account when evaluating whether*** ***the cost statements as a whole are free from material misstatement.***

Para	Description
5.6	***Prior to evaluating the effect of uncorrected misstatements, the cost auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the cost auditor shall consider:*** ***a) the size and nature of the misstatements, both in relation to classification, measurement and assignment of cost to cost objects or disclosures in the cost statements, and the particular circumstances of their occurrence; and*** ***b) the effect of uncorrected misstatements related to prior periods on the classification, measurement and assignment of cost to cost objects or disclosures in the cost statements.***
5.7	***The cost auditor shall communicate with those charged with governance uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the cost auditor's report, unless prohibited by law or regulation. The cost auditor's communication shall identify material uncorrected misstatements individually. The cost auditor shall request that uncorrected misstatements be corrected.***
5.8	***The cost auditor shall also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the classification, measurement and assignment of cost to cost objects or disclosures in the cost statements.***
5.9	***The cost auditor shall request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the cost statements. A summary of such items shall be included in or attached to the written representation.***
5.10	***The cost auditor shall include in the audit documentation:*** ***(a) The amount below which misstatements would be regarded as clearly trivial;*** ***(b) All misstatements accumulated during the cost audit and whether they have been corrected; and*** ***(c) The cost auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate and the basis for that conclusion.***

A misstatement may not be an isolated occurrence. Evidence that other misstatements may exist include, for example, where the cost auditor identifies that a misstatement arose from a breakdown in internal control or from inappropriate selection or application of costing policies or unreasonable valuation methods.

16.3 ACCUMULATING IDENTIFIED MISSTATEMENTS

Misstatements identified during the audit, other than those that are clearly trivial, should be aggregated. They can also be distinguished between factual misstatements, judgmental misstatements, and projected misstatements.

The cost auditor may designate criteria for identifying misstatements that would be clearly trivial and would not need to be accumulated because the cost auditor expects that the accumulation of such amounts clearly would not have a material effect on the cost statements. “Clearly trivial” is not another expression for “not material.” Matters that are clearly trivial are matters that are clearly inconsequential, whether taken individually or in aggregate and by whatever criteria judged i.e. size, nature or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

Most quantitative misstatements can be aggregated so that the overall impact on the cost statements can be evaluated. However, some misstatements (such as incomplete or inaccurate cost statement disclosures) and qualitative findings (such as the possible existence of fraud) cannot be aggregated.

Undetected misstatements could exist because of the presence of sampling risk and non-sampling risk. There may be a greater level of risk that materiality could exceed due to undetected misstatements when taken along with aggregate of misstatements accumulated during the audit.

Identified misstatements are to be discussed with management on a timely basis along with the request tocorrect them. Corrections could affect cost statement balances or rectify inadequate cost statementdisclosures. The steps involved in addressing identified misstatements are set out below.

Addressing Identified Misstatements	
Re- evaluate Materiality	Consider whether it may be necessary to revise the overall materiality prior to evaluating the effect of uncorrected misstatements, based on the actual operating results.
Consider the Reasons and Impact on Audit Plan	Consider the reasons for the misstatements identified during the audit. This includes: • Potential indicators of fraud; • Possible existence of other misstatements;

Addressing Identified Misstatements	
	• Existence of an unidentified risk; or • A significant deficiency in internal control. In light of the findings above, determine whether the overall audit strategy and audit plan need to be revised. This would be necessary when: ➢ Other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or ➢ The aggregate of misstatements accumulated during the audit approaches materiality.
Request Management to Make Correction	Ask management to correct all identified misstatements, other than those that are clearly trivial
Ask Management to Perform Additional Procedures	If the precise amount of misstatement in a population is not known (such as in a projection of misstatements identified in an audit sample), ask management to perform procedures to determine the amount of the actual misstatement, and then to make appropriate adjustments to the cost statements. Where this occurs, some additional audit procedures will be necessary by the cost auditor to determine whether any misstatements remain.
Management Refuses to Correct Some or All Misstatements	If management refuses to correct some or all of the misstatements: • Obtain an understanding of management's reasons for not making the corrections, and take this understanding into account when evaluating whether the cost statements are materially misstated; • Communicate uncorrected misstatements with those charged with governance, including their effect on the opinion in the cost auditor's report (unless prohibited by law or regulation); and • Request that those charged with governance correct the misstatements that remain uncorrected by management.

Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform the cost auditor if it disagrees, and take action as necessary. Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the misstatements and to take the necessary action.

Law or regulation may restrict the cost auditor's communication of certain misstatements to management, or others, within the entity. 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 seeking legal advice.

The correction by management of all misstatements, including those communicated by the cost auditor, enables management to maintain accurate cost records and reduces the risks of material misstatement in future cost statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.

In forming a conclusion as to whether the uncorrected misstatements (individually or in aggregate) would cause the cost statements as a whole to be materially misstated, the auditor would consider the factors outlined below.

Addressing Identified Misstatements	
Is there a Material Misstatement	The size and nature of misstatements, in relation to: ○ The cost statements as a whole; ○ Particular item of cost, cost heads, consumption levels, classes of transactions, account balances, and disclosures; and ○ The particular circumstances of their occurrence. The limitations inherent in judgmental or statistical testing. There is always thepossibility that some misstatements may not be found. How close is the likely level of aggregate uncorrected misstatement to materialitylevel(s)? The risks of material misstatement increase as the likely aggregatemisstatement approaches the materiality threshold. Quantitative considerations or the possibility of fraud where misstatements of arelatively small amount could have a material effect on the cost statements. The effect of uncorrected misstatements related to prior periods.

The cost auditors must consider all the misstatements, or errors, they detect during the course of their audit work and make a judgement about how they could affect the cost statements. This will involve discussion with the management about amending the cost statements where individual misstatements are material. If the misstatements are individually small this will involve deciding whether, collectively, they are significant enough to affect the presentation of the cost statements as whole; *lots of small errors can add up to a large one!*

The cost auditor has to identify each material misstatement individually. The cost auditor may discuss with those charged with governance the reasons for, and the implications of, a failure to correct misstatements, having regard to the size and nature of the misstatement judged in the surrounding circumstances, and possible implications in relation to future cost statements.

It is management's responsibility to adjust the cost statements to correct material misstatements(including inadequate disclosures) and to implement any other actions required.

16.4 QUALITATIVE CONSIDERATIONS

The cost auditor should evaluate qualitative considerations while determining materiality for misstatement due to classification such as the effect due to classification of overheads on individual cost item or cost objects or key ratios.

There may be circumstances where the cost auditor concludes that a classification misstatement is not material in the context of the cost statements as a whole, even though it may exceed the materiality level or levels applied in evaluating other misstatements.

Examples of such considerations are outlined below:

Misstatements that:	**Descriptions**
Affect compliances	Non-compliance with regulatory requirements or other contractual requirements i.e. determination of assessable value for goods sold for captive consumption
Mask changes	For example, change in contribution or other trends, especially in the context of general economic and industry conditions
Increase management compensation	Misstatement that would ensure that the requirements for compensation incentives is satisfied
Impact other parties	For example, external and related parties
Affect user's	Omission of information (not specifically required) but in

Misstatements that:	Descriptions
understanding	the judgment of the cost auditor is important to the users' understanding of the operatingperformance of the entity.i.e capacity utilization
Are Immaterial now but significant in future	Incorrect selection or application of an cost accounting policy that has an immaterial effect on the current period's cost statements, but is likely to have a material effect on future periods' cost statementsi.einadequate change in useful life of assets
Affects performance ratios	Affects ratios used to evaluate the entity's performanceand current position, results of operations. i.e Cost of goods sold / Total Revenue *100, BOM Cost / Cost of goods sold * 100

16.5 WRITTEN REPRESENTATIONS

Management's responsibility is to be evidenced by obtaining a written representation from management. This representation will state that any uncorrected misstatements (attach or include a list) are, in management's opinion, immaterial both individually and in the aggregate. If management disagrees with the assessment of misstatements, it may add to its written representation words such as:

"We do not agree that items...and...constitute misstatements because [description of reasons]."

Note: When the cost auditor communicate findings with those charged with governance, there is a requirement to identify material uncorrected misstatements individually.

Where uncorrected misstatements by management are reported to those charged with governance and corrections are still not made, the cost auditor is required to obtain a similar representation. This would state that those charged with governance also believe that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the cost statements as a whole. A summary of such items is also to be included in or attached to the written representation.

Obtaining this representation does not, however, relieve the cost auditor of the need to form a conclusion on the effect of uncorrected misstatements.

16.6 REVISION AS THE AUDIT PROGRESSES

Before the cost auditor evaluates the results of performing procedures and any misstatements arising there from, the first step is to reassess the amounts established for overall and performance materiality. This is necessary because the initial determination of materiality will often be based on estimates of the entity's cost statement and presentation of operating results, and the actual results may be different. Factors that would lead to a change include:

a) Initial determination of materiality is no longer appropriate in the context of the entity's actual cost results;

b) New information becomes available (such as user expectations) that would have caused the auditor to determine a different amount (or amounts) initially; and

c) Unexpected misstatements that may cause the materiality amount for that particular class of transactions, account balance, or disclosure to be exceeded.

Whenever a revision is necessary, the cost auditor is required to consider and document the impact on the assessed risks and the nature, timing, and extent of further audit procedures required.

If a lower materiality is required for the financial statements as a whole, also determine if it is necessary to revise performance materiality. If so, determine whether the nature, timing, and extent of the further audit procedures remain appropriate.

16.7 DOCUMENTATION

The cost auditor's documentation of misstatements may take into account:

a) The criteria for determining the materiality of a misstatement

b) The misstatements that have been corrected & those which have not been corrected.

c) The consideration of the aggregate effect of uncorrected misstatements;

d) The evaluation of whether the materiality level or levels for particular classes of transactions, cost objects or disclosures, if any, have been exceeded; and

e) The evaluation of the effect of uncorrected misstatements on key ratios or trends, and compliance with legal, regulatory and contractual requirements.

No standards + no measures + no penalties = no direction

From leadership 101

CHAPTER –17 AUDIT DOCUMENTATION

Audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions reached by the cost auditor. The cost auditor shall also document discussions of significant matters, when and with whom the discussions took place.

According to the Wikipedia, The word "Document" is used to refer to a written,drawn, presented, or memorialized representation of thought. It also denotes everything that may be represented or memorialized in order to serve as evidence. The word "Documentation" refers to the act or an instance of the supplying of documents or supporting reference or records.

"Audit Documentation means the records, in physical or electronic form, including working papers prepared by and for, or obtained and retained by the cost auditor, in connection with the performance of the audit".

"Audit working papers are the documents which record all audit evidence obtained during audit. Such documents are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the relevant Cost Auditing Standards".

"Audit file means one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific Assignment or audit"

The cost auditor should document all matters which are important in providing evidence to support the opinion given in the cost audit report. Documentation here means the working papers prepared by and for, or obtained and retained by the cost auditor in connection with the performance of cost audit. Working papers may be in the form of data stored on paper, film, electronic media or other media. Working papers record the audit evidence, resulting from the cost audit work performed, to support the cost auditor's opinion. The extent of working papers is a matter of professional judgement. They may cover the detailed aspects of the cost audit or may include the daily work sheets or daily diary maintained by each member of the cost audit staff engaged on the assignment.

Good Audit Documentation is appropriately organized, and provides a record of the work done, audit procedures performed the audit evidence obtained, the significant professional judgement applied, and the conclusion reached. Preparing the audit documentation on timely basis helps to enhance the quality of audit. Documentation prepared after the audit work has been performed is likely to be less accurate than the documentation prepared during execution.

The audit documentation shall be sufficient to enable an experienced auditor, having no connection with the audit of specific entity, to understand the nature, timing and extent of audit procedures performed, compliance with cost accounting standards and other legal and regulatory requirements, the result of audit procedure performed, audit evidence obtained, significant matters arising out of audit and how they were addressed and audit conclusions reached with the underlying professional judgments for reaching such conclusion.

The audit documents should have self custody, easy but protected accessibility. If the data / information / audit evidence is in electronic form, it must be retrievable only with proper authorization. The real test will be the full confidentiality. A safeguard should be taken so that the documentation or audit evidence is not altered, or additions or deletions made without the knowledge of the proper authority. The documentation should be fully protected from physical loss or damage. The electronic documents should have proper and safeguarded password protection and back up mechanism. The audit documents should be divided in sections and properly indexed with serial numbers.

The audit documentation should be retained depending upon the relevance and significance of the same in relation to the matter authenticated or certified by the auditor. Normally the audit documentation should be retained for a minimum period of 10 years from the date of signing the report. However, the legal provisions or regulations will override the firm's policy regarding the retention of such documentation. The audit documentation is the property of the Cost Auditor. Unless otherwise specified by law or regulation, he may at his discretion, make portions of, or extracts from audit documentation available to clients.

Important Point

In principle, compliance with the requirements of SCA-102 "Cost Audit Documentation" will result in the audit documentation being sufficient and appropriate in the circumstances. Other SCAs contain specific documentation requirements that are intended to extend the application of SCA-102 in the particular circumstances of those other SCAs. The specific documentation requirements of other SCAs do not limit the application of SCA-102.

Furthermore, the absence of a documentation requirement in any particular SCA is not intended to suggest that there is no documentation that will be prepared as a result of complying with that particular SCA. Audit documentation provides evidence that the audit complies with the SCAs.

Cost Audit documentation that meets the requirement of this SCA and the specific documentation requirements of other relevant SCAs provides:

(a) Evidence of the cost auditor's basis for a conclusion about the achievement of the overall objectives of the cost auditor; and

(b) Evidence that the cost audit was planned and performed in accordance with SCAs and applicable legal and regulatory requirements.

Cost Audit documentation serves a number of additional purposes, including the following:

(a) Assisting the audit team to plan and perform the cost audit.

(b) Assisting members of the audit team responsible for supervision to direct and supervise the cost audit work, and to discharge their review responsibilities.

(c) Enabling the audit team to be accountable for its work.

(d) Retaining a record of matters of continuing significance to future cost audits.

(e) Enabling the conduct of quality control reviews in accordance with the Guidance Manual for Audit Quality issued by Quality Review Board (QRB).

(f) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

In the process of audit documentation, the cost auditor shall record;

(a) Identifying characteristics of specific items including cost items, cost records, other items and matters tested.

(b) Who performed the audit work and date?

(c) Who reviewed audit work with dates of review?

(d) Discussion of significant matters with the management or those charged with governance, nature of significant matters and when and with whom discussion took place.

(e) Information, if any, about any significant matter that is inconsistent with overall audit report and how the inconsistency report

(f) Departure, if any, in exceptional circumstances, from a relevant requirements specified in any standard / stipulation prescribed by any regulatory authority including institute, reasons for such departure and how application of alternative audit procedure fulfilled the requirements.

Audit documentation must be sufficient and appropriate, and oral explanations by the Cost Auditor cannot substitute for such documentation.

17.2 NEED FOR AUDIT DOCUMENTATION

Documentation is considered the backbone of an audit. The work that the auditor performs, the explanations given to the auditor, the conclusions arrived at, are all evidenced by documentation. Poor documentation depicts poor performance in an audit. The auditor may have executed appropriate audit procedures, however, if there is no documentation to prove, it is equal to having not done any work at all. Improper and incomplete documentation, at times, may even put the auditor in embarrassing situations

17.2.1 Documentation is Essential Because:

- It helps in planning an audit
- It assistssupervision and review.
- It results in better conceptual clarity, clarity of thought and expression.
- It facilitates better understanding and helps avoid misconception.
- It supports and evidences work performed and compliances with standards.

17.2.3 Significance of Audit Documentation

Audit documentation (whether maintained on paper or electronically) plays a critical role in:

(a) Assisting the engagement team in planning and performing the audit;

(b) Providing evidence to demonstrate that the planned audit procedures were in fact performed;

(c) Assisting engagement reviewers (including engagement quality control reviewers) in carrying out their

(d) Responsibilities in accordance with professional standards;

(e) Recording the judgments involved in forming the audit opinion; and

(f) Recording matters of continuing significance for future audits of the entity.

17.3 SIGNIFICANT MATTERS

Matters that give rise to significant risks of a material misstatement are significant matters. Those that causes a revision of the Cost Auditor's previous assessment of the risks of material misstatement is also a significant matter. The Cost Auditor may have reached a certain conclusion regarding the misstatement of the Material Cost in a Cost statement based on the availability of a well documented Bill of Materials but his assessment of risk may undergo a change if he finds that there is considerable use of substitute and alternate materials in the actual production process. Matters that cause the Cost Auditor significant difficulty in applying necessary audit procedures are also significant, as for example heaps of bulk material in irregular shapes which make volumetric measurement of stock in a physical stock taking unreliable.

Determining what are significant matters in an audit to warrant their inclusion in the documentation must be objectively done. The conclusions reached and the application of professional judgment in respect of these also needs to be documented. For example, the determination of the normal capacity for applying overheads is a significant matter in Cost Audit and requires not mere calculations but considerable judgment. These should be adequately documented.

17.4 GENERAL TIPS FOR COST AUDITOR ON AUDIT DOCUMENTATION AND WORKING FILES

a) **Clarity and Understanding -** The preparer of audit documentation shall understand the objectivity of documentation and also explain the requirements of documents to be kept documented to other engagement team.

b) **Completeness and Accuracy -** Working papers should be complete, accurate and support observations, testing, conclusion and recommendation. The preparer should also recognize the nature and scope of the work performed.

c) **Pertinence –** Limitthe information in working papers to matters that are important and necessary under to support the objective and scope established for the assignment.

d) **Logical Arrangement –** Working paper should be filled in logical order with proper indexing.

e) **Legibility and Neatness –** Working paper and files should be legible and neat as much as practical. Sloppy papers may lose their worth as audit evidence. Crowding and writing between lines between should be avoided by anticipating space needs and arranging the work papers before writing.

f) **Safety –** Keep your papers safe and retrievable.

g) **Initial and Date –** Put your initials and date on every working paper and document obtained while auditing.

h) **Basis of Audit Opinion –** Record adequately the basis of audit opinion formed and any written representation made on the same, also document the reply received on audit opinion, reservation and qualifications.

i) **Summary of conclusions –** Summarizethe work performedand identify the overall significance of any weakness or exceptions found.

Relevant Requirements of SCA-102 "Audit Documentation" arereproducedbelow:

Para No.	Particulars
5.2	***The Cost Auditor shall prepare audit documentation that is sufficient to enable another competent person, having no previous connection with the said audit, including person undertaking peer review to understand:*** ***13 Conformance of audit procedures performed with legal and regulatory requirements;*** ***14 Conformance to Cost Auditing Standards;*** ***15 The results of audit procedures performed;*** ***16 The audit evidence obtained; and*** ***17 Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.***
5.3	***Shall record the discussions of significant matters with client personnel and outsiders.***
5.4	***Shall record any departure from the standard requirement in a Cost Auditing Standard.***
5.5	***In documenting the nature, timing and extent of audit procedures performed, the Cost Auditor shall record the characteristics of the specific items or matters tested, the persons responsible for performing and reviewing such procedures with relevant dates and extent of review.***
5.7	***If, in exceptional circumstances, Cost Auditor performs any new or additional audit procedures or draws new conclusions, after the date of Cost Audit Report, then he shall document such circumstances and details of such procedures performed.***
5.9	***The Cost Auditor shall ensure adherence to the relevant clauses of the Guidance Manual for Audit Quality issued by Quality Review Board (QRB) constituted u/s 29A of The Cost and Works Accountants***

17.5 CONTENT AND FORM OF AUDIT DOCUMENTATION

These will depend on a number of factors such as:

(a) the size and complexity of the operations of the auditee,
(b) the extent of computerization of cost records,
(c) the assessed risks of material misstatement of cost,

(d) the cost audit methodology and tools used. For example whether automated queries were used to get audit evidence from cost records.
(e) the nature of the audit procedure to be performed

Generally the factors that determine the form and contents of documentation for a particular engagement are:

(a) The nature of engagement i.e. General Purpose, Specific Purpose,

(b) The nature of the business activity of the client i.e. manufacturing, batch, joint product, by- product, rendering service, captive consumption,

(c) The status of client i.e. Regulatory, Non-Regulatory, Manufacturing orServices or both,

(d) Reporting Format - Detailed or Abridge,

(e) Relevant legislation applicable to the entity i.e. Telecom or Power Sector,

(f) Records maintained by entity i.e. System oriented, Manual, verified or unverified

(g) Internal control in operations i.e.Real time settlement or backlog,

(h) Quality of engagement team and need to direct and supervise their work i.e. Manager, Quality Reviewer or adequate team.

17.6 AUDIT FILE ORGANIZATION

An area to be addressed by entity-wide policies is audit file organization and indexing. A consistent approach using a standard index has a number of advantages, such as the following:

- Enables specific working papers to be easily located and shared among audit team members;
- Facilitates file review by the various reviewers such as the manager, engagement partner, engagement reviewer, and quality control monitors (if any);
- Provides consistency between audit files in the firm; and
- Assists with quality of cost audit such as checking for missing sign-off s, invalid cross-references, and unclear review notes.

Audit documentation is usually organized into logical divisions of work using an indexing system. If the file is electronic, the indexing can be in the form of folders and sub-folders. As each piece of audit documentation is created, it will be given a unique reference that ties directly into the overall file index.

Index No	Index by Cost Statement Area
01	Cost Statements and Cost Auditor's Report
08	File Completion Memo, Checklist, etc.
09	Overall Audit Strategy
17	Materiality
83	Risk Assessment Procedures
14	BoM Cost
15	Overheads
04	Assertions
03	Process Flow Chart
35	Engagement Letter
57	Written Representation
61	Contingencies
92	Other Supporting Documents
43	Inventory
68	Power & Fuel
77	Indirect Tax Reconciliation
80	Audit findings
95	Other Experts Opinion
10	Team Allocation Schedule

17.6.1 Permanent and Current Audit files

In the case of recurring audits, some working paper files may be classified as permanent audit files, which are updated currently with information of continuing importance to succeeding audits. In contrast current audit files contain information relating primarily to the audit of a single period.

- Copy of initial appointment letter if the engagement is of recurring nature.
- Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.
- NOC from previous auditor.
- Organisational structure of the client.

- List of governing body including Name, Address and contact details, for Instance, the List of Directors in case of a company.
- Extracts or copies of important legal documents, agreements and minutes relevant to the audit i.e. supply contract, works contract, distribution agreement or leasing of facilities agreement.
- A record of the study and evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.
- Process / Operation Flow charts.
- Copies of audited financial / cost statements for previous years and reconciliation of cost and financial statements.
- Analysis of significant ratios and trends i.e. BOM Ratio, Variance Analysis, Consumption to sales ratio.
- Copies of management letters issued by the auditor, if any.
- Notes regarding significant cost accounting policies.
- Significant audit observations of earlier years.
- Assessment of risks and risk management.
- Major policies related to Purchases and Sales.
- Details of sister concerns i.e. captive power plant, captive unit.
- Details of Related Parties.
- Systems and Data Security policies.
- Business Continuity Plans.

The current file normally includes:

(a) Correspondence relating to acceptance of annual reappointment.

(b) Extracts of important matters in the minutes of Board Meetings and General Meetings, as are relevant to the audit.

(c) Evidence of the planning process of the audit and audit programme

(d) Analysis of item of cost, cost heads, transactions and balances.

(e) A record of the nature, timing and extent of auditing procedures performed, and the results of such procedures

(f) Evidence that the work performed by assistants was supervised and reviewed.

(g) Copies of communications with other auditors, experts and other third parties.

(h) Copies of letters or notes concerning audit matters communicated to or discussed with the client, including the terms of the engagement and material weaknesses in relevant internal controls.

(i) Letters of representation or confirmation received from the client.

(j) Conclusions reached by the auditor concerning significant aspects of the audit, including the manner in which exceptions and unusual matters, if any, disclosed by the auditor's procedures were resolved or treated. i.e communication of fraud and representation of management related to fraud.

(k) Copies of the cost information being reported on and the related audit reports.

(l) Audit review points and highlight.

(m) Audit opinion and Audit Report

The requirements when making changes to audit file between the Cost Audit Report Date and Documentation Completion Date are:

For administrative changes:

- Document the nature of audit evidence obtained, who prepared and reviewed each document, and any additional memos to file that may be required;
- Delete or discard superseded documentation;
- Sort, collate, and cross-reference working papers; and
- Sign off any completion checklists relating to the file assembly process.

For changes in the audit evidence or conclusions reached, additional documentation should be prepared that addresses three key questions:

- When and by whom such additions were made and (where applicable) reviewed;
- The specific reasons for the additions; and
- The effect, if any, of the additions on the audit conclusions.

The requirements when making changes to audit file after Documentation Completion Date are:

- No documentation should be deleted or discarded from the audit file until the file retention period has expired.
- Where it is necessary to make additions (including amendments) to audit documentation after the documentation completion date, the three key questions about changes in audit evidence, outlined in Period 1 above, should be answered, regardless of the nature of the additions.

The Cost Audit documentation will usually contain:

(a) **Checklists; Example**: Checklist of compliance with:-

(i) The Rules, regarding maintenance of Cost Records, as prescribed under the Companies Act,

(ii) The Cost Accounting Standards (CAS) as prescribed by the Institute

(iii) The Generally Accepted Cost Accounting Principles (GACAP) as prescribed by the Institute

(b) **Audit programs:** Example: Audit Program for Material Cost, Employee Cost and others.

(c) **Analysis:** Cost Audit relies more on analytical review than on substantive testing to establish true and fair view. Example: Calorific value of different fuels used and average Cost per unit of calorific value and Specific Heat Consumption.

(d) **Audit Query List:** Contains a log of audit queries raised and their resolution.

(e) **Abstracts of significant contracts relating to costs and revenues:** Example: Supply of materials indicating price, quality terms, O & M contracts, Terms of supply of contract labour and others.

(f) **Letters of confirmation:** Example: Stock of materials with subcontractors.

(g) **Letter of Representation from Management Correspondence (including e-mail) concerning significant matters.** Example: Correspondence regarding terms of supply of goods and services.

(h) Abstract or copies of the entity's records

17.7 TYPICAL AUDIT DOCUMENTATION

This would include the items listed (illustrative) below:

- Pre- Engagement (client acceptance) Procedures**.**
- Independence and Conflict of Interest
- Terms of Engagement.
- Review of Cost Accounting Standards and material departure with the principle or disclosure required under CAS
- Materiality Considerations.
- Overall Audit Strategy.
- Audit Team Discussion, including possible causes of material misstatement due to fraud.

- Key elements of understanding of the entity obtained, and of each of the internal control relevant to audit including the source of the information obtained.
- Risk Assessment Procedures performed, and the results.
- Assessed Risks of Material Misstatement identified (at overall assertion levels), based on the understanding of the entity obtained and related internal control (if any)
- Significant matters and risks associated with and their resolution, such as material uncertainties, concern with management cost estimates and other matters that could result in a modified audit opinion.
- Communications with Management and Those Charged with Governance.
- An audit Plan that address :
  - All material cost statements area;
  - The assessed risk of material misstatement at the cost statement level and assertion level;
  - The nature, timing and extent of further audit procedures performed that respond to the assessed risks; and
  - Significant risk identified
- Significance and nature of the evidence obtained to the assertion being tested.
- A clear explanation of the results obtained from the test, and how any exceptions or deviations were followed up. This includes:
  - The basis for the test;
  - The choice of population;
  - The level of assessed risk; and
  - The sampling intervals and choice of the starting point.
- Actions taken as a result of auditing procedures that indicate:
  - Need to modify planned auditing procedures;
  - Material misstatements may exist;
  - Omissions in the cost statements; or
  - The existence of significant deficiencies in internal control over cost reporting.
- Changes, if any, required to the overall audit strategy.
- Use of significant judgments applied on significant matters in performing work and evaluating results.
- Discussions with management on significant matters.
- Summary of item of cost or cost head wise effect of unadjusted errors identified, and Management’s response (i.e., adjustments made).
- Non- trivial uncorrected misstatements

- Memoranda, analysis, details of assumptions used, and how the validity of the underlying information used was established.
- Cross-references to supporting documentation and evidence that the cost statements agree or reconcile with the underlying accounting records.

The Cost Audit Documentation in respect of smaller entities may be less detailed than what is indicated but must include at the minimum the following:

(a) A description of the entity, the products produced, services provided and other activities
(b) An organization Chart showing the responsibility centres and the person responsible
(c) A description, preferably a flow chart of the manufacturing process
(d) Internal controls over material cost, labour cost and expenses
(e) The risks of material misstatement assessed, for example, in respect of scrap recovery and disposal
(f) Tests of materiality used
(g) The overall audit strategy and audit plan
(h) Significant matters noted during the audit, and conclusions reached

17.8 GUIDANCE TO AUDIT TEAM ON AUDIT DOCUMENTATION

Proper guidance should be given to staff regarding the following

(a) Filing/keeping of working papers
(b) Checklist of documents to be obtained and maintained
(c) Indexing of documents/ working papers
(d) Proper numbering/ sequencing of working papers
(e) Summarizing of overall findings
(f) Writing of queries
(g) Discussing with seniors on matters of importance
(h) Disposing of Query -at staff level/ senior level/ partner level
(i) Importance of the working papers to be signed, dated and approved by relevant level of audit staff with sufficient cross reference
(j) Importance of depicting the client's name, file number, accounting period, subject of working paper and reference of working paper with current or permanent file

17.9 RELEVANT REQUIREMENTS OF SCAS WITH RESPECT TO AUDIT DOCUMENTATION

In principle, compliance with the requirements of SCA-102 "Cost Audit Documentation" will result in the audit documentation being sufficient and appropriate in the circumstances. Other SCAs contain specific documentation requirements that are intended to clarify the application of SCAs-102 in the particular circumstances of those other SCAs.

The specific documentation requirements of other SCAs do not limit the application of SCA-102.

Furthermore, the absence of a documentation requirement in any particular SCA is not intended to suggest that there is no documentation that will be prepared as a result of complying with that particular SCA. Audit documentation provides evidence that the audit complies with the SCAs. However, it is neither necessary nor practicable for the cost auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the cost auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the cost auditor has agreed the terms of the audit engagement with management or, where appropriate, those charged with governance.
- An auditor's report containing an appropriately qualified opinion on the cost statements demonstrates that the cost auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SCAs.
- In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file, For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the cost auditor's exercise of professional skepticism in accordance with the SCAs. Such evidence may include specific procedures performed to corroborate management's responses to the cost auditor's inquiries.

17.9.1 Electronic Audit Documentation

Many cost auditing and accounting firms or cost auditor have replaced (or are in the process of replacing) paper-based engagement files with electronic files. In some cases, even though the work was performed and reviewed electronically, paper files are maintained as the permanent record of work performed. Documents/forms are initiated in digital form, client records are scanned electronically, and all data is stored electronically. It is printed on paper only after all the work is completed and reviewed.

There are two types of electronic documents:

- Work-in-process; and
- Static information.

17.9.2 Work-in-Process

Work-in-process consists of dynamic information that is being developed and updated as the audit progresses. Examples include blank audit forms and letter templates, industry knowledge and key performance indicators, questionnaires, logic trees, the entity's policies, diagnostics and the previous period's financial data, cost data information, assumptions, reconciliation etc. that may be used in performing this period's analytical procedures. This information is often contained within software applications and electronic audit tools.

17.9.3 Static Information

Static information consists of final file documents, such as the cost statements and completed working papers, that will not change and may well be required for reference in future years. Final or static documents must be retained in a format where the information can be retrieved easily in later years.

17.9.4 Advantages of Automation

Maintaining audit files in an electronic form enables some administrative functions to be automated, and provides additional flexibility for engagement team members. For example:

- Specific working papers can be accessed directly from the index;
- Files and documents can be easily shared or reviewed with others in distant locations;
- New audit folders and documents can be created, renamed, moved, copied, or deleted from the index;
- The detailed index can be collapsed to reveal its overall structure, or expanded as needed, making it easier to see the big picture and locate key documents;
- Customized names can be given to important documents. This can help other team members to interpret the contents of a document from its name;
- Review functions can be automated such as checking all or part of the audit file for exceptions, outstanding review notes, and preparer/reviewer sign-off s;
- Engagement team members can share file documents by using electronic check-in and check-out tools;
- Certain documents can be password protected for enhanced security; and
- Access to files can be restricted to authorized personnel.

17.9.5 Using Electronic Tools in Working Papers

There are three important principles to note when using electronic tools in working papers preparations:

- All the requirements of the SCAs still apply;
- Electronic files require electronic document management
- Final documents (all document that are required to be maintained to support the audit opinion) must be retained and be accessible with the auditor's / firm's file retention policies.

17.10 LIST OF SPECIFIC REQUIREMENTS PROVIDED IN RESPECTIVE SCAS

This list will help the cost auditor to list out the specific documentation as per the requirements of specific SCA

Para No.	*Particulars*	*Audit Documentation Required*
SCA – 101 "Planning an Audit of Cost Statement"		
5.8	**Planning**	☞ Overall Audit Strategy ☞ Overall Audit Plan ☞ Significant changes made in Audit Strategy and Audit Plan during the audit **For example** Audit Memorandum, Audit Planning Schedule, Resource Planning, Time and Job Allocation, Engagement Team , Audit Procedures, Materiality Level, Audit Programme
SCA – 104 " Knowledge of Business, its Process and the Business Environment"		
5.6	**Key Elements Understanding of Entity and its Environment**	Relevant industry, regulatory, and other external factors including the applicable cost reporting framework. The nature of the entity, including: ☞ its operations; ☞ its ownership and governance structures; ☞ the types of strategy that the entity is making and plans to make, the way that the entity is structured and how it is functions ☞ Application of cost accounting policies and evaluation of whether such policies are appropriate for business performance ☞ The entity's objective and Strategies and those related business risk that may results in risk of material misstatements ☞ Control Environment – Auditor's evaluation of whether : ☞ Management with oversight of those charged

Para No.	*Particulars*	*Audit Documentation Required*
		with governance ☞ The strength and weakness of controls ☞ Entity Risk Assessment Process ☞ IT Controls and significant observation regarding IT controls ☞ Control Activities Relevant to Audit ☞ Understanding the Relevance of Internal Audit Functions ☞ Risk of Material Misstatement identified at a) cost statement level b) Assertion Level
SCA – 108 "Materiality in Planning and Performing an Audit"		
5.6	**Determination of Materiality**	☞ Materiality level for Cost statements for establishing overall strategy ☞ Materiality level for particular items of cost, cost heads , classes of transactions, accounts and balances or disclosures ☞ Determination of Performance Materiality for assessing the risk of material misstatement and nature, timing and extent of further audit procedures. ☞ Determine whether it is necessary to revise materiality level during the course of audit. ☞ Revision of materiality level , if cost auditor finds that materiality level was lower as initially determine or performing further audit procedures
SCA – 109 "The Cost Auditor's Responsibilities Relating to Fraud in an Audit of Cost Statement"		
5.29	**Understanding of entity's and its environment**	☞ Assessment of Risks of Material Misstatement. ☞ Significant Decision ☞ Assessed risk of Fraud at the Cost Statement Level or Assertion Level
5.30	**Responses to Assessed Risk**	☞ Overall Response to Material Misstatement due to fraud ☞ Nature and timing of audit procedures ☞ Linkage between audit procedures and assessed risk.

Para No.	*Particulars*	*Audit Documentation Required*
		☞ The result of audit procedures including those designed to address the risk of Management override of controls
5.31	**Communication**	Communication about fraud made to management, those charged with governance, regulators and other bodies or personnel.
SCA – 111 "Evaluation of Misstatements identified during the Cost Audit"		
5.10	**Uncorrected Misstatements**	☞ Level below which misstatement would be regarded as clearly trivial ☞ The cost auditor's documentation of misstatements may take into account: a) The criteria for determining the materiality of a misstatement b) The misstatements that have been corrected & those which have not been corrected. c) The consideration of the aggregate effect of uncorrected misstatements; d) The evaluation of whether the materiality level or levels for particular classes of transactions, cost objects or disclosures, if any, have been exceeded; and e) The evaluation of the effect of uncorrected misstatements on key ratios or trends, and compliance with legal, regulatory and contractual requirements. ☞ The cost auditor's conclusion as to whether uncorrected misstatement are material, individually or in aggregate and basis for that conclusion.
SCA – 113 " Using the Work of Internal Auditor"		
5.22	**Using the work of Internal Auditors**	☞ The nature and extent of the audit procedures performed to comply with applicable legal and regulatory requirements in context of related party disclosures like: (a) the basis adopted to determine the value of transaction; (b) name of Related Parties identified indicating transactions or supplies made or service rendered.

Para No.	*Particulars*	*Audit Documentation Required*
		(c) matters arising during the audit and audit evidence obtained by the cost auditor. The conclusions reached during the course of audit through application of the significant professional judgments in reaching the conclusions. (d) contracts or agreements entered into or reached in respect of: (i) purchase and sale of raw materials, finished good(s), rendering of services(s), process materials and rejected goods including scraps, etc; (ii) utilization of plant facilities and technical know-how; (iii) supply of utilities and any other services; (iv) administrative , technical , managerial or any other consultancy services; (v) purchase and sale of capital goods including plant and machinery; and (vi) any other payment related to the production of goods or rendering of services under reference. ☞ Nature and extent of the work used and basis for decision ☞ Conclusion regarding the evaluation of the adequacy of the work of Internal Auditors. ☞ Audit procedures performed on that work to determine its adequacy
5.23	**Direct Assistance**	If cost auditor uses internal auditors to provide direct assistance on the audit (a) The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance; (b) The basis for the decision regarding the nature and extent of the work performed by the internal auditors; (c) Who reviewed the work performed and the

Para No.	Particulars	Audit Documentation Required
		date and extent of that review; (d) The written agreements obtained from an authorized representative of the entity and the internal auditors under paragraph 5.19; and (e) The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.
SCA – 114 " Using the Work of Cost Auditor Expert"		
Extract of Standards	**Determining the need for a Cost Auditor's Expert-**	Basis for determination the need for cost auditor's expert and reasons and challenges faced while obtaining audit evidence determining in area such as Expertise in a field other than accounting or auditing may include expertise in relation to such matters as: (a) Determination of installed/ achievable capacity of plant, machineries, process, product etc.; (b) Determination and or verification of consumption norms of various inputs like material, labour, machine hours, technical standards etc.; (c) Impact on consumption norms of various inputs due to change in production process, change in technology, or substitute of major input material(s) etc.; (d) Efficiency of machines, boiler etc. which has significant impact on determination of machine hour rate, labour hour rate and or utilities consumption pattern; or (e) The interpretation of contracts, laws and regulations (f) Area needed in which the cost auditor expert's is such as ▪ Obtaining an understanding of the entity and its environment, including its internal control. ▪ Identifying and assessing the risks of material misstatement. ▪ Determining and implementing overall responses to assessed risks at the cost

Para No.	*Particulars*	*Audit Documentation Required*
		statement level. ▪ Designing and performing further audit procedures to respond to assessed risks at the assertion level, comprising tests of controls or substantive procedures. ▪ Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the cost statements. (g) Agreement with cost auditor's expert , competence level, confidentiality, threats exits for independence and safeguard taken to avoid such threats (h) How the work of cost auditor's is used and necessary audit evidence obtained. (i) Assumption and method used by cost auditor's (if any)
SCA – 117 "Identifying and Assessing the Risk of Material Misstatement"		
5.22	**Risk Assessment Procedures**	☞ Factors influenced the Risk of Material Misstatement either due to error or fraud ☞ Discussion among Audit Team ☞ Significant Decision reached ☞ Identified Risk of Material Misstatement at assertion level or cost statement ☞ Related Controls
SCA – 118 "The Cost Auditor's Response to Assessed Risk"		
SCA – 119 " Related Parties"		
5.19	**Related Parties**	☞ Names of Related Parties ☞ Nature of Relationship ☞ Nature of transactions held ☞ Applicable Regulatory Requirement in Context of Related Parties ☞ Nature and extent of audit procedures performed **For example** The nature and extent of the audit procedures

Para No.	Particulars	Audit Documentation Required
		performed to comply with applicable legal and regulatory requirements in context of related party disclosures like: ▪ the basis adopted to determine the value of transaction; ▪ name of Related Parties identified indicating transactions or supplies made or service rendered. ▪ matters arising during the audit and audit evidence obtained by the cost auditor. The conclusions reached during the course of audit through application of the significant professional judgments in reaching the conclusions. ▪ contracts or agreements entered into or reached in respect of: ▪ purchase and sale of raw materials, finished good(s), rendering of services(s), process materials and rejected goods including scraps, etc; ▪ utilization of plant facilities and technical know-how; ▪ supply of utilities and any other services; ▪ administrative , technical , managerial or any other consultancy services; ▪ purchase and sale of capital goods including plant and machinery; and ▪ any other payment related to the production of goods or rendering of services under reference.

Incorrect documentation is worse than no documentation

By Bertrand Meyer

CHAPTER -18 AUDIT OPINION & AUDIT REPORT

The final step in the audit process is to evaluate the audit evidence obtained, consider the impact of any misstatements identified, form an audit opinion, and prepare an appropriately worded audit report.

The cost auditor's report communicates the following information to the reader:

- Responsibilities of management;
- Responsibilities of the cost auditor and a description of the audit;
- The audit of cost statements was conducted in accordance with Standards on Cost Auditing;
- The cost reporting framework used; and
- The cost auditor's opinion on the cost statements.

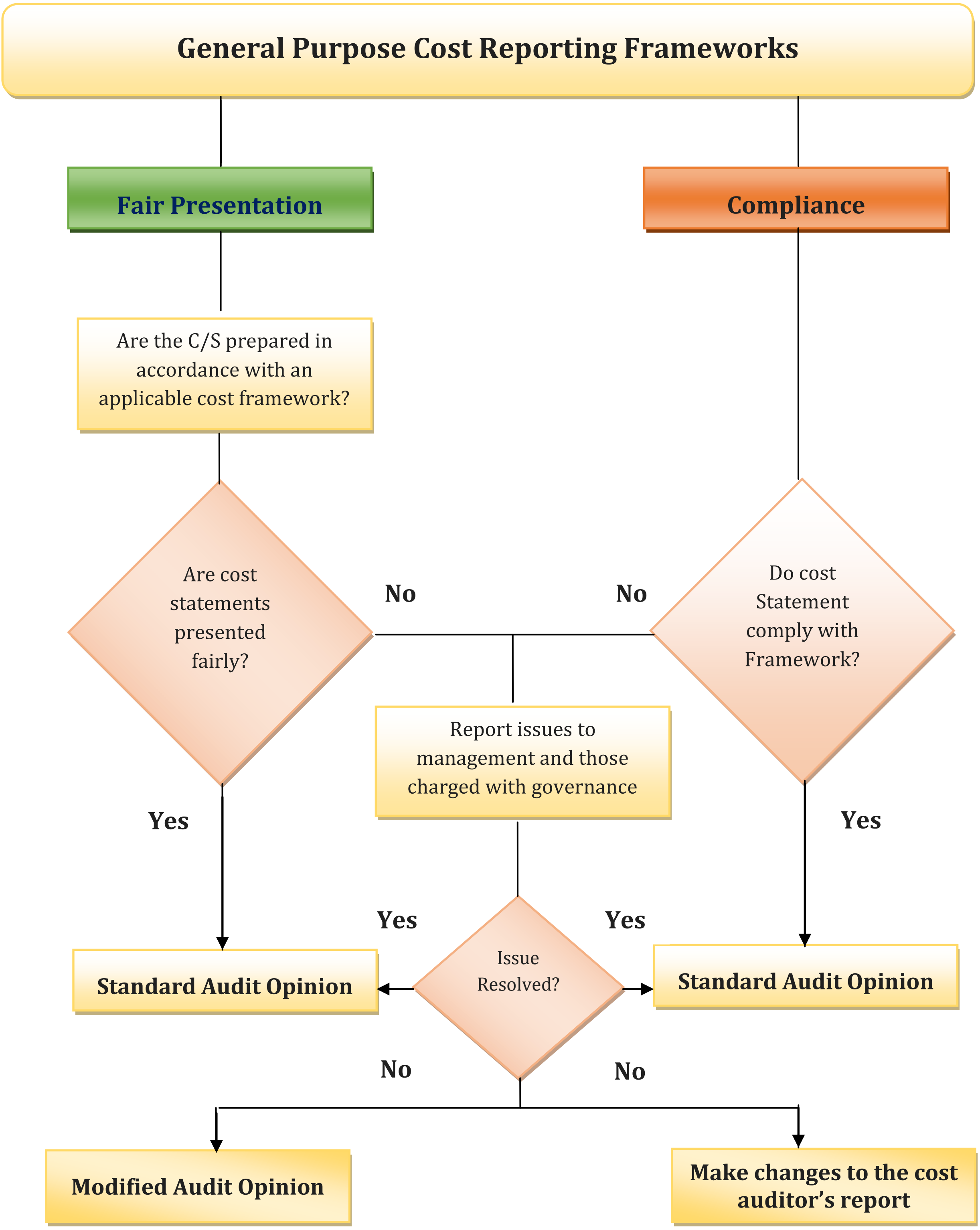
When forming an opinion, the cost auditor needs to ensure that the statements are prepared in accordance with the applicable cost reporting framework as outlined below:

Considerations	
Forming an Audit Opinion	**Materiality** Conclude whether: ➢ Materiality remains appropriate in the context of entity's actual operating results. ➢ Uncorrected misstatements (including uncorrected misstatements related to prior periods), either individually or in aggregate, could result in a material misstatements. **Audit Evidence** ➢ Has sufficient appropriate audit evidence been obtained? ➢ Are the cost accounting estimate made by management reasonable? ➢ Did the analytical procedures performed at or near the end of audit corroborate conclusion formed during the audit of cost statements? **Accounting Policies** ➢ Do the cost statements adequately disclose the significant cost accounting policies selected and applied? ➢ Are the cost accounting policies consistent with the cost

Considerations	
	reporting framework, and appropriate in the circumstances?
	Cost Statement Disclosures ➢ Do the cost statements refer to or describe the applicable reporting framework? ➢ Have all cost statement disclosure been made as required by the applicable cost reporting framework? ➢ Is the terminology used in cost statements, including the title of each cost statements, appropriate? ➢ Are there adequate disclosures to enable intended users to understand the effect of material transaction and events on the information conveyed in the cost statements? ➢ Is the information presented relevant, reliable, comparable, understandable and sufficient? ➢ Do the cost statements provide the adequate disclosure to enable the intended users to understand the effect of material transactions and events on the information conveyed in the cost statements?
	Fair Presentation Frameworks ➢ Do the overall presentation, structure, and content (including the note disclosures) faithfully represent the underlying transactions and events in accordance with the applicable cost reporting framework? If not, is there a need to provide disclosures beyond those specifically required by the framework to ensure fair presentation? ➢ Are the cost statements, after any adjustments made by management as a result of the audit process, consistent with the understanding obtained about the entity and its environment?
	Compliance Frameworks ➢ Are the cost statements misleading? This is likely only in extremely rare circumstances.

18.1 FORMING AN OPINION ON COST STATEMENTS

A decision tree for forming an opinion under general purpose frameworks is outlined below.



In some cases, the cost auditor may be required to conduct an audit in accordance with both frameworks. In these situations, the cost auditor's opinion would refer to both the fair presentation framework and the applicable legal or regulatory requirements.

Based on the results of the evaluations outlined above, the cost auditor would determine what form of audit report (unmodified or modified) is appropriate in the circumstances, as outlined below.

Type of Opinion	Cost Auditor's Conclusions
UnmodifiedOpinion	The cost statements are prepared, in all material respects, in accordance with the applicable cost reporting framework, and an unmodified opinion would be appropriate.
Modified Opinion (Qualified, Adverse or Disclaimer)	• Based on the audit evidence obtained, the cost statements as a whole are not free from material misstatement; or • Sufficient appropriate audit evidence could not be obtained to conclude that the cost statements as a whole are free from material misstatement.

The form of the cost auditor's report will be affected by the cost reporting framework used, any additional requirements required by law or regulation, and the inclusion of any supplementary information. The cost auditor's report is required to highlight headings for each paragraph as follows:

- Report on the Cost Statements;
- Management's Responsibility for the Cost Statements;
- Cost Auditor's Responsibility; and
- Opinion.

Other headings for paragraphs that may be used where applicable are:

- Emphasis of Matter; and
- Report on other legal and Regulatory Requirements.

The main components of the cost auditor's report are outlined below:

Component	Comments
Title	**Cost Auditor's Report** Using the word "Cost" distinguishes the cost auditor's report from reports issued by others.
Addressee	**Those for Whom the Report Is Prepared** (typically Board of Directors or those charged with governance) This may also be dictated by the circumstances of the engagement or local regulations.
Introductory Paragraph	• Identifies the entity whose cost statements have been audited. • States that the cost statements have been audited.

Component	Comments
	• Identifies the title of each of the Cost statements that comprise thecomplete set of cost statements. • Refers to the summary of significant cost accounting policies and other explanatory notes. • Specifies the date and period covered by the cost statements. Where supplementary information is presented, explains whether it is covered by the cost audit opinion or clearly differentiates it as not being covered.
Management's (or other Appropriate Term) Responsibility for the Financial Statements	Explains that management is responsible for the preparation of the cost statements in accordance with the applicable cost reporting framework. The report states that management is responsible for: • The preparation and fair presentation of the cost statements in accordance with the applicable cost reporting framework; and • Such internal control as management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error .**Management responsibility includes:** • Accepting responsibility for internal control necessary to enable the cost statements to be free from material misstatement, whether due to fraud or error; • Selecting and applying appropriate cost accounting policies; • Ensuring the information contained in the cost statements is relevant, reliable, comparable, and understandable; • Ensuring adequate disclosure to ensure material transactions are understood by users of the cost statements; and • Making cost accounting estimates that are reasonable in the circumstances.
Cost Auditor's Responsibility	States that the responsibility of the cost auditor is to express an opinion on the cost statements based on the audit. This includes: • Stating that the audit was conducted in accordance with Standards on Auditing. The auditor's report should also explain that those standards require that the auditor comply with ethical requirements, and that the auditor plan and perform the audit to obtain reasonable assurance about whether the cost statements are free from material misstatement. • Describing an audit by stating:

<table>
<tr><th>Component</th><th>Comments</th></tr>
<tr><td></td><td>An audit of cost statement involves performing procedures to obtain audit evidence about the amounts and disclosures in the cost statements,
The procedures selected depend on the cost auditor's judgment, including the assessment of the risks of material misstatement of the cost statements, whether due to fraud or error. In making those risk assessments, the cost auditor considers internal control relevant to the entity's preparation of the cost statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control, and
An audit of cost statements also includes evaluating the appropriateness of the cost accounting policies used, the reasonableness of cost accounting estimates made by management, as well as the overall presentation of the cost statements.
Stating that the cost auditor believes that the audit evidence the cost auditor has obtained is sufficient and appropriate to provide a basis for the cost auditor's opinion.
Where cost statements are prepared in accordance with a fair presentation framework, the description of the audit of cost statements shall refer to "the entity's preparation and fair presentation of the cost statements" or "the entity's preparation of cost statements that give a true and fair view," as appropriate in the circumstances.</td></tr>
<tr><td>Cost Auditor's Opinion</td><td>Fair Presentation Frameworks
States whether the cost statements present fairly, in all material respects, (or give a true and fair view of) in accordance with the applicable cost reporting framework, or such similar wording as required by law or regulation.

Compliance Frameworks
States whether the cost statements are prepared in all material respects in accordance with the applicable cost reporting framework. i.e. CRA –I</td></tr>
<tr><td>Other Reporting Responsibilities</td><td>Certain Standards, law, or generally accepted practices in a jurisdiction may require or permit the cost auditor to report on other responsibilities, such matter would be addressed in a</td></tr>
</table>

Component	Comments
	separate paragraphs following cost auditor's opinion.
Cost Auditor' Signature	The cost auditor's signature will be based on what is appropriate for the particular jurisdiction. It could be the firm name, personal name of the cost auditor, or both. It may also require the cost auditor's professional accountancy designation or reference to the fact that the cost auditor/firm has been recognized by the appropriate licensing authority.
Date of Report	This is no earlier than the date on which the auditor obtained sufficient appropriate audit evidence on which to base the opinion. This evidence includes: • A complete set of cost statements has been prepared; • Consideration of the effect of events and transactions (of which the auditor became aware) that occurred up to that date; and • Assertions by those with the recognized authority that they have taken responsibility for the cost statements.
Cost Auditor / Firms Address	Indicate the name of the cost auditor's / cost auditor firm location in the jurisdiction where the cost auditor practices.

18.2 MODIFICATION TO COST AUDIT REPORT

The cost auditor is required to clearly express an appropriately modified opinion on cost statements in situations such as those set out below.

	Situations
Modified Report **{Qualified, Adverse or Disclaimer of Opinion}**	**Cost Statement are Materially Misstated** Based on the audit evidence obtained, the cost statements as a whole are not free from material misstatement. This would include uncorrected misstatements that are material, the appropriateness or application of cost accounting principles, and the failure to disclose information that results in a material misstatement.
	Inability To Obtain Sufficient Appropriate Audit Evidence Unable to obtain sufficient appropriate audit evidence to conclude that the cost statements as a whole are free from material misstatement. This could include: • Circumstances beyond the control of the entity, such as a fire that damaged cost accounting records; • Circumstances relating to the nature or timing of the cost

	Situations
	auditor's work, such as an inability to capture physical inventory on cut off date ; or • Limitations imposed by management, such as management not allowing the cost auditor to obtain an external confirmation of certain third party stock.

There are three types of modified opinions are as follows:-

(a) Qualified
(b) Adverse
(c) Disclaimer

The appropriate use of these three types of modification is outlined below

Type	Applicability
Qualified Opinion	When the effect is not material and pervasive enough to require an adverse or disclaimer of opinion. This applies where: • Sufficient appropriate audit evidence was obtained, but the auditor concludes that misstatements exist, individually or in the aggregate, that are material but not pervasive to the financial statements; or • The cost auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion. The cost auditor concludes that the possible effects on the cost statements of undetected misstatements, if any, could be material but not pervasive. ***Worded as: "Except for the effects (or the possible effects) of the matter described in the Basis for Qualified Opinion paragraph…"***
Adverse Opinion	When the effects of misstatements are both material and pervasive. This applies where sufficient appropriate audit evidence was obtained, but the cost auditor concludes that misstatements, individually or in the aggregate, are both material and pervasive to the cost statements. ***Worded as: "In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph…the cost statements do not present fairly…"***
Disclaimer of Opinion	When the possible effect of undetected misstatements, if any, could be both material and pervasive. This applies where the cost auditor

Type	Applicability
	is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and concludes that the possible effects of undetected misstatements, if any, could be both material and pervasive. This also applies to extremely rare circumstances where it is not possible to form an opinion due to the potential interaction of multiple uncertainties and their possible cumulative effect on the cost statements. This applies even where the cost auditor has obtained sufficient audit evidence regarding each of the individual uncertainties. ***Worded as: "Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the cost statements."***

The illustration below outlines how the type of opinion to be expressed is affected by cost auditor's judgement about;

- The nature of the matter giving rise to the modification; and
- The pervasiveness of its effect or possible effects on the cost statements.

Nature of Matter Giving Rise to the modifications	Cost Auditor's Judgement about the Pervasiveness of the Effect or Possible Effect on the cost statements	
	Material but not Pervasive	**Material but Pervasive**
Cost statements are materially misstated	**Qualified Opinion**	**Adverse Opinion**
Inability to obtain sufficient appropriate audit evidence	**Qualified Opinion**	**Disclaimer of Opinion**

The only alternative to issuing an adverse or disclaimer of opinion would be withdrawing from the audit altogether (where permissible) and not issuing an opinion.

When a modification is required, the details would be provided in a *"basis for modification"* as paragraph described below.

Basis forModificationParagraph	**Purpose** Sets out details of the modification in a separate paragraph uniformly worded to the extent possible) preceding the opinion or disclaimer of opinion on the cost statements. The paragraph would be headed ***"Basis for Qualified Opinion,""Basis for Adverse Opinion,"*** or ***"Basis for Disclaimer of Opinion."*** **Wording** The paragraph would include: • The substantive reasons for qualification; • Unless impracticable, quantification of the possible effect(s) on the cost statements of modifications involving specific amounts in the cost statements (including quantitative disclosures). This would include quantification of the effects on the item of cost , cost heads, account balances, classes of transactions and disclosures affected, plus the effect on net income, and equity; • When applicable, a statement that it is not practical to quantify the cost effects; • Where the material misstatement relates to narrative disclosures, an explanation of how the disclosures are misstated; • Nature of omitted information unless disclosures are not readily available, not prepared by management, or would be unduly voluminous in the report; and • A description of all identified matters that would have required a modification of the cost auditor's opinion. An adverse or disclaimer of opinion relating to one specific matter does not justify the omission of other matters that would have required a modified cost auditor's report.
Notes to the Cost Statements	The cost auditor's report may make reference to a more extensive discussion in a note to the cost statements.(if any or if require)

Before concluding that a modified opinion is required, the cost auditor would:

- Attempt to obtain sufficient appropriate audit evidence by performing alternative procedures; and
- Discuss the matter with management and those charged with governance to determine if the issue can be resolved. If the matter cannot be resolved, the cost auditor would then communicate the intention to modify the audit opinion and the proposed wording.

An Illustrative format of cost Audit Report is appended as Appendix – XI

Quality is a moving target and you have to keep aiming at it constantly

By N Vaghul

Appendix – I

Know Your Client & its Business Environment

(Understanding Business Process)

I. Client Overview

(a) Entity History

Provide a description of relevant client background

Entity Profile

- ✓ Nature of Business
- ✓ Number of Plant / Branches/Offices (if any)
- ✓ Directors /Key Managerial Persons
- ✓ Major Shareholders (if requires)
- ✓ CEO (Address and Phone no)
- ✓ CFO (Address and Phone no.)
- ✓ Plant Head (All Units) (Address and Phone no.)
- ✓ Internal Audit Head (Address and Phone no)
- ✓ Company Secretary (Address and Phone no)
- ✓ List of Related Parties
- ✓ Tax Advisor
- ✓ Statutory Auditor
- ✓ Other Professionals (if necessary)
- ✓ Major Customers and Suppliers
- ✓ Major Bankers (if requires)
- ✓ Organizational Charts
- ✓ Vision and Mission

(b) Entity Business Objectives and Related Business Strategies

Provide a summary of the objectives, strategies and method of implementing the strategies

Business Objectives	Related Business Strategies
1.	
2.	
3.	

(c) Entity Business Components

(i) Major Markets

(ii) Major Products and Services

(iii) Major Customers

(iv) Major Competitors

(v) Alliances (including customers & suppliers) & other relationships

(d) Notes of Meeting with Entity / Client *(for recurring audits)*

Client Name		
Date		
Venue		
Time		
Firm Representative	Name	Designation
Client Representative	Name	Designation
Concluding Remarks		
Prepared by	Name , Designation & Date	
Signed by	Name , Designation & Date	

Agenda for Meeting

Latest / Last Audited Cost / Financial Accounts	
Coordinating Person	
Information about other cost auditors and experts / Internal Auditor Report /Internal Controls Manual/ Standards Operating Procedures / IT Systems and any change in the same	
Areas requiring special attention	
Physical Verification (Inventory / Third Party)	
Client expectation of completion of test of controls	
Expected date of client to finalize cost / financial statements	
Client expectation of completion of cost audit	
Expected date of client to submit first cut cost statements for review and audit	
Any significant cost accounting / accounting and auditing issues during the previous audit which are brought	

forwards	
Internal Auditor Report and significant findings during internal audit	
Change in economic conditions	
Change in Industry and Operations	
Significant changes in business since last year	
Changes in key finance and operations Managers	
Changes in management/ stakeholders/ owners	
Business objectives and whether they are being met	
Changes in market strategies	
Availability of latest forecast / Budgets	
Actual results to date (comment generally)	
Restriction placed by Contract Covenants	
Changes in pricing / distribution / logistics policy since last year	
Changes in information systems and technology in use	
Changes in significant accounting / cost accounting Processes	
Effects of any recent or pending government legislation / actions i.e Assessable value for goods sold for captive consumption	
Effect of any new tax rules / legislation, for example, GST	
New competitors in product lines of the Company	

Changes in market share	
Significant changes in major customers / suppliers	
Changes in internal reporting formats	
Significant changes in system of internal controls since last year	
Whether any instances of fraud or material error during the year. How management / those charged with the governance responded?	
Significant changes in accounting Policies	
Effect of new accounting Pronouncements i.e Indian Accounting Standard	
Clients international reporting requirements and changes thereto i.e Transfer Pricing Policy	
Miscellaneous	

II. Business Control Environment

When analyzing the business control environment understand the client's

- Business Structure
- Culture and Ethics
- Remuneration Management
- Personnel Profile (if find necessary in some cases)
- Communication of Information / Information Flow

Business Structure

Culture and Ethics

Remuneration Management

Communication of Information / Information Flow

III. Strategic Management Process

When analyzing the client' strategic management process, provide a description of how management:

- Set the overall direction for the client;
- Monitors the external environment and assess the strategic implications of potential opportunities and threats;
- Monitors the extent to which strategies have been implemented;
- Understands the strategies and capabilities of major competitors;
- Analysis the client strengths and weakness;
- Allocate Resources and facilitates to its business process;
- Aligns process objectives with strategic objectives.

IV. Computer Information Systems

Business processes are often facilitated by computer information systems. Obtain an Understanding of the:

- Level of dependence the client has on computer information systems (include a list of the client's computer information system);
- Computer information systems personnel structure and skills;
- Security of computer information system ; Access Controls, Backups. Disaster Recovery

- Degree and Rate of change in Computer Information Systems
- Dependence on external computer processing ; Use of service organization, understanding and evaluation thereof.

V. Cost Reporting Environment

Obtain understanding of the;

- Cost reporting framework applicable to entity;
- Cost accounting policies applied by the entity and applied within the industry
- Potential impact of cost accounting policies upon specific aspects of the cost statement.

Cost Reporting Issues

Consider the following for identification of reporting framework issues to be addressed while analyzing or consulting with engagement team , partner , reviewer or other experts;

- Client' s cost accounting policies (it is always better to also analyze the general accounting policies for the purpose of understanding and reconciliation between cost and financial accounts)
- New Cost Accounting / Accounting pronouncements; (Indian Accounting Standards or ICDS and its impact on cost statements).
- Going concern assumptions
- Legal or other regulatory changes i.e change in turnover for the purpose of cost audit.

Cost Reporting Issues	**Reasons for Identification**

VI. Critical Audit Areas / Significant Cost Statements Components

Critical audit areas are generally those where judgment is involved and significant estimation is used. The approach to those areas and resulting impact on the cost statements relating to the audit is documented. It also includes consideration of previous years brought forward issues. Following are some of the critical areas for only guidance purposes. Other critical areas may be included in this section as per the cost auditor's assessment.

Critical Audit Area / Objective	*Reason for identification*	Management Response	Proposed Audit Approach / Procedures
BOM Cost			
Power and Fuel			
Production Overhead			
Indirect Expenses			
Administrative Overhead			
Selling & Distribution Overhead			
Employee Cost			
Inventory Valuation (WIP/ FG / RM)			
Classification of Cost			
Allocation / Absorption of Cost			
Depreciation			
Captive Consumption			
Capacity Utilization			
Conversion Cost			
Revenue / Other Income			

VII. Reason for use of Experts and Other Professionals

This description should include a summary of the issue, why it is considered significant and its potential effects on the cost statement. As a result, the issue may be included as a significant issue on the basis that the potential effect on cost statement may be a significant non-routine transaction, requires a great deal of judgment or is complex, and not necessarily that it has been confirmed as a critical audit objective. Specialists may include:

- Computer Information System (CIS) Specialist
- Tax expert
- Other specialist or other party involved in the audit e.g. Actuary, Valuers
- Internal auditor, Co-auditor
- Chartered Engineers, etc

Involvement of : CIS (Computer Infirmation Specialist)
Description of basis, nature, extent and conclusion related to the involvement of CIS Specialist; (Description)

Involvement of : Other Professional or Experts or Valuers
Description of basis, nature, extent and conclusion related to the involvement of other professionals; (Description)

Prospective Client Acceptance/Existing Client's Continuation Memorandum

The cost auditor should be generally more careful about accepting the new client because of lack of previous experience with the management and those charged with the governance and knowledge of the business, transactions and associated risks affecting the cost statements.

While certain assessment procedures for both the prospective and existing clients would be common, however, they may assume additional importance in case of a new client. The cost auditor also needs to communicate with the predecessor cost auditor.

This illustrative memorandum should be filled and signed before accepting all the new / initial cost audit engagements.

I. Prospective client identity and source (consider following questions)

- ✓ Whether the entity is one of the following

  a) Listed / Non- Listed

b) Regulatory / Non- Regulatory
c) Multi- locational / Multi Products
d) Manufacturing / Service Industry / both
e) Other (Specify)

- ✓ What has been cost auditor's experience with the client or any other company of the same group?
- ✓ Has the work been referred for specific engagements?
- ✓ What are the significant risks associated with accepting new client?
- ✓ Consider that no conflict of interest arises in respect of service being provided as a result of accepting audit of cost statements in view law and regulations, code of ethics and other legal provisions?

II. Background information on the business / operations

- ✓ What is known about prospective business / operations client?
- ✓ What is the business goodwill / market share of the prospective client, its promoters / those charged with governance, and its management?
- ✓ How capable is / are the management / those charges with the governance in managing operations ?
- ✓ What is known about the integrity of the principal owners/those charged with the governance and management?
- ✓ Is there a dominant Chief Executive Officer / Chief Financial Officer / Chief Management Officer?
- ✓ Whether the cost auditor can meet with the Audit Committee/ Board of directors freely and without the Executives present?
- ✓ What is the operational status of the prospective client (particularly capacity determination / joint product – by product, multi products, discontinuing operations ,multi product lines , power and other gas and fuel generations and viability)?
- ✓ Whether the management has a significant personal financial interest in the operational result?

- ✓ What is the integrity of those with significant influence over cost reporting (including fraudulent acts, non-bias in producing estimates, revenue/ earnings management)?
- ✓ What is known about the industry in which the prospective client operates and the risks it presents?
- ✓ What reasons are given for the change of cost auditor(s) and why we or our firm was selected?
- ✓ Whether the cost auditor / firm is competent and capable of handling the audit of cost statements of the prospective client?
- ✓ Whether there would be need of a cost auditor's expert?
- ✓ In case of lead audit engagements whether the engagement team is capable of acting as lead auditors? What are profile of other cost auditor(s)
- ✓ Is there any concern that the laed engagement team will not be able to gain sufficient appropriate audit evidence in relation to the consolidation process and the cost information of the components/ units on which to base the lead cost auditor(s) opinion?

III. Results of enquires with third party

- ✓ Enter the details of discussion with third parties (i.e. regulator, Job worker, supplier?

IV. Cost auditor's association with prospective client (consider the following questions)

- ✓ Whether the preconditions for an audit of cost statements are present, that is, the use by management of an acceptable cost reporting framework in the preparation of the cost statements and the agreement of management or those charged with governance to the premise on which an audit of cost statements is conducted?

- ✓ Whether any limitation of scope is likely that would result in a disclaimer of cost auditor's opinion?
- ✓ What is the need to accept the cost audit even where the limitation on scope is or likely to be imposed by the management?
- ✓ Are there any relationships that may impair cost auditor's objectivity or ability to meet any relevant independence requirements?
- ✓ Are there any potential conflict of interest affecting auditor's ability to accept the engagement? For example providing cost audit and maintenances of cost records services to the same client. If there is a conflict of interest whether the interest conflicting with audit of cost statements removed or safeguards available that reduces the risk to an acceptable level?
- ✓ Have any relevant statutory or other regulatory provision been identified, including any implications on the auditor's ability to act for the client?

1. Conflicts of Interest

Enter details of issues that might lead to potential conflict of interest?

2. Expertise

Enter details of the skill and experience the cost auditor has makes it suitable for this client.

3. Fee Recovery

Enter details of the estimated fees, and review that an acceptable level of recovery of audit cost is expected.

4. **Other Services**

   Comment on the potential for providing other services to the client and suggest actions for taking advantages of these, i.e. benchmarking, process mapping.

V. Initial assessment of risk associated with the prospective client

Specify the areas of concern that the client presents and explain how the risk will be managed.

VI. Results of enquires with predecessor cost auditor

Document the results of enquiries with predecessor cost auditor and comment on the same.

VII. Independence Factors

Consider all factors that could impair the cost auditor /firm's or network's independence for engagement including Statutory, Legal, Regulatory or Code of Ethics and other applicable independence rules. Determine if any of the following challenges are present:

1. Proposed or prospective services
2. Firm financial or business relationships with the client
3. Ex-cost auditor/ firm staff working for the client in a position of influence
4. Cost auditor / Firm professionals who were formerly employed by the client with involvement in the cost audit engagement
5. Audit team's and other covered persons' family members employed by the client

6. Long association of a senior team member with the client

VIII. Other Factors

Enter details of any other areas of concern or issues for consideration. For example, whether the firm has previously decline to perform cost audit engagement for this client if so give reasons and state mitigating factors for acceptance?

IX. Conclusion

On the basis of the above, we conclude that there is no reason to believe that the overall level of risk associated with ________________________ is sufficient to prevent the client from being accepted and there are no other circumstances of which we are aware associated with _________ _______________that suggest that the client should not be accepted.

OR

The circumstances identified from the above assessment have been disposed of as follows:

1. ___________________
2. ___________________

Significant risks

Based on the assessment following significant risks are identified, which needs to be addressed while planning and performing the audit

1. ______________
2. _______________

OR

On the basis of above and due to-------------------------- the offer is declined.

Signed ______________ . ______________
Proposed Engagement partner / Cost Auditor Senior partner

. ______________ . ______________
Date Date

II. Existing Client Continuation/ Retention Memorandum

S No.	Description	Yes	No
1	Is there a significant change in the nature, size or structure		

S No.	Description	Yes	No
	of the client's business / operations? If yes state increased risk associated with the change and why the cost auditor /firm should still continue with such client.		
2	Is there a request by another partner for re-evaluation of the engagement? If yes, state reasons for such request.		
3	Is there any new legal, regulatory or professional requirements that alter the planning, performance and reporting responsibilities?		
4	Are there any concerns about a team member's ability to meet the applicable requirements?		
5	Is there any new legal, regulatory or professional requirements that alter the planning, performance and reporting responsibilities?		
6	Is there a significant change in management or those charged with the governance?		
7	Is there any reason whether due to past experience or present development to question or be concerned about the reputation, character, or integrity of management and/or those charged with the governance?		
8	Is there any known problem of independence by reason of activities or relationships of partner or professional staff in relation to the client?		
9	Is the client involved in any significant current or possible litigation?		
10	Did the client re-evaluation indicate a change in operation performance of the client?		
11	Whether there would be need of an cost auditor's expert?		
12	Are there any concerns over the resources available within the cost auditor / firm to meet any identified need for experts?		
13	In case of lead audit engagement whether the engagement team is capable of acting as lead auditors?		
14	Is there any concern that the lead engagement team will not be able to gain sufficient appropriate audit evidence in		

S No.	Description	Yes	No
	relation to the consolidation process and the cost information of the components/ units on which to base the lead audit opinion?		

Independence Factors

Consider all factors that could impair the cost auditor /firm's or network's independence for engagement including Statutory, Legal, Regulatory or Code of Ethics and other applicable independence rules. Determine if any of the following challenges are present:

1. Other services provided to the entity and its related entities in the previous 2 years
2. Proposed or prospective services
3. Firm financial or business relationships with the client
4. Ex-cost auditor/ firm staff working for the client in a position of influence
5. Cost auditor / Firm professionals who were formerly employed by the client with involvement in the cost audit engagement
6. Audit team's and other covered persons' family members employed by the client
7. Long association of a senior team member with the client
8. Threat of replacement over a disagreement with cost accounting policy (s)/ cost reporting framework

Changes to Audit Risks and Other Matters

Consider matters (including any identified in the Client Acceptance) including whether there are issues in relation to:

1. Going concern, financial viability, operational viability, continued existence
2. Related parties
3. Current or possible litigation against the client
4. Compliance with laws and regulation including any regulatory investigations
5. Suspected or identified frauds
6. Items noted in Cost Statement review, if any
7. Internal audit reports / Internal Controls
8. Other matters

Conclusion

On the basis of the above it is concluded that the firm should / should not continue our client engagement.

If decided to continue:

The circumstances identified (if any) from the above assessment have been disposed of as follows:

1. ___________________________
2. ___________________________

Significant risks

Based on the assessment following significant risks (if any) are identified which needs to be addressed while planning and performing the audit of cost statements:

1. --
2. --
3. --

Signed _______________	. _______________
Proposed Engagement partner / Cost Auditor	Senior partner
. _______________	. _______________
Date	Date

Appendix – II

Illustrative Cost Audit Engagement Letter

The following is an example of a cost audit engagement letter for an audit of general purpose cost statements prepared in accordance with Cost Accounting Standards (CAS). This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this Standard. It will need to be varied according to individual requirements and circumstances. It is drafted to refer to the audit of cost statements for a single reporting period and would require adaptation if intended or expected to apply to recurring cost audits (see paragraph 5.8 of SCA-105). It may be appropriate to seek legal advice that any proposed letter is suitable.

***

The Board of Directors[1]
[or those charged with governance]
ABC Company

[***The objective and scope of the cost audit***]

You[2] have requested that we audit the cost statements of ABC Company, which comprise the following:[3]

1. quantitative details of capacity, production and sales;
2. cost sheet showing element-wise per unit cost of production of goods or provision of services, cost of sales and margin for each product or service;
3. reconciliation of profits, as per cost accounts and as per financial accounts;
4. statement of value addition and distribution of earnings; and
5. any explanatory note annexed to, or forming part of, any document referred to in (i) to (iv) above.

We are pleased to confirm our acceptance and our understanding of this cost audit engagement by means of this letter. Our cost audit will be conducted with the objective of our expressing an opinion on the cost statements, cost records and other related cost information.

[***The responsibilities of the cost auditor***]

[1]The addresses and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction.
[2]Throughout this letter, references to "you", "we", "us", "management", "those charged with governance", and "cost auditor" would be used or amended as appropriate in the circumstances.
[3]Details comprising cost statements may be amended as required under the applicable cost reporting framework, or as prescribed by law or regulation. .

We will conduct our cost audit in accordance with standards on cost auditing issued by the Institute of Cost Accountants of India. Those standards require that we comply with ethical requirements and plan and perform the cost audit to obtain reasonable assurance about whether the cost statements are free from material misstatement. An audit involves performing procedures to obtain the audit evidence about the amounts and disclosures in the cost statements. The procedures selected depend on the cost auditor's judgment, including the assessment of the risks of material misstatement of the cost statements, whether due to fraud or error. Cost audit also includes evaluating the appropriateness of cost accounting policies used and the reasonableness of cost accounting estimates made by management, as well as evaluating the overall presentation of the cost statements.[4]

Because of the inherent limitations of cost audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the cost audit is properly planned and performed in accordance with standards on cost auditing.

In making our risk assessments, we consider internal control relevant to the entity's preparation of the cost statements in order to design cost audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the cost statements that we have identified during the cost audit.

[***The responsibilities of management and identification of the applicable cost reporting framework*** *(for purposes of this example it is assumed that the cost auditor has not determined that the law or regulation prescribes those responsibilities in appropriate terms; the descriptions in paragraph 5.1(b) of SCA-105 are therefore used)*]

Our cost audit will be conducted on the basis that management and where appropriate, those charged with governance, acknowledge and understand that they have responsibility:

(a) For preparation and presentation of cost statements in accordance with applicable cost reporting framework that gives true and fair per unit cost of production or cost of operations, cost of sales, and margin for each product or service or activity, produced or provided your company for the period under audit;

(b) For selection and consistent application of appropriate cost accounting policies;

(c) For implementation of cost accounting standards issued by the Institute, alongwith proper explanation relating to any material departures from those cost accounting standards;

[4] Where the cost statements of the entity include cost statements/information of its other units which has been audited by another cost auditor/cost auditors, the engagement letter may be modified accordingly.

(d) For such internal control as the [management] determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error; and

(e) To provide us with:

a. Access, at all times, to all information, including the books, account, vouchers, cost records, other records, documentation, and other matters of the company, whether kept at the head office of the company or elsewhere, of which [management] is aware that is relevant to the preparation of the cost statements;

b. Additional information that we may request from [management] for the purpose of the cost audit; and

c. Unrestricted access to persons within the entity from whom we determine it necessary to obtain cost audit evidence. This includes our entitlement to require from the officers of the company such information and explanations as we may think necessary for the performance of our duties as cost auditor.

As part of our cost audit process, we will request from [management and where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the cost audit.

We look forward to full cooperation from your staff during our cost audit.

[***Other relevant information***]

[*Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.*]

[***Reporting***]

[*Insert appropriate reference to the expected form and content of the cost auditor's report*]

The form and content of our report may need to be amended in the light of our cost audit findings.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our cost audit of the cost statements including our respective responsibilities.

....

XYZ & Co.
Cost Auditors
(Proprietor/Partner)

Acknowledged and agreed on behalf of ABC Company by
(Signed)

....
Name and Title
Date

Appendix- III

Illustrative Audit Strategy Memorandum and Memo

Development of the overall audit strategy begins at the commencement of the engagement, and is completed and then updated based on the information obtained from:

- Previous experience with the entity
- Preliminary (client acceptance and continuation) activities
- Knowledge from previous audits and other engagements with the entity
- Knowledge of business
- Discussions with the entity on changes since last period and recent operating results
- Audit team discussions and meetings
- Other external sources such as newspaper and Internet articles
- New information obtained, failed audit procedures, or new circumstances encountered during the audit that will change previously planned strategies
- Nature and scope of the audit
- Statutory deadlines and reporting format
- Relevant factors determining the direction of the audit efforts
- Nature, timing and extent of resources required for the audit

The time required to prepare an overall audit strategy will vary based on:

- Size and complexity of the entity
- Composition and size of the audit team
- Circumstances encountered in performing the audit

Developing the Overall Audit Strategy

The overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team. The strategy will document the decisions arising from conducting the planning steps outlined in the exhibit below. Specific details of risk assessment and further audit procedures to be performed would be documented in the detailed audit plan.

Basic Steps	Description
Getting Started	• Perform preliminary activities (client acceptance/ continuance and establish the terms of cost audit engagement).

Basic Steps	Description
	• Gather relevant information about the entity such as current operating results, results from previous cost audit engagements, and significant changes in the current period. • Assign staff to the engagement, including, where applicable, the engagement quality control reviewer and any experts required. • Schedule the audit team meeting (including the engagement partner) to discuss the susceptibility of material misstatements (due to error or fraud) in the cost statements. • Determine the appropriate timeframes (dates) when each aspect of audit work will be undertaken (inventory valuation, risk assessment procedures, external confirmations, the period-end visit, and meetings to discuss cost audit results).
Assessing Risks and Responses	• Determine materiality for the cost statements as a whole, and performance materiality. • Determine the nature and extent of the required risk assessment procedures and who will perform them. • When risk has been assessed at the cost statement level, develop an appropriate overall response. Also include the impact on the further audit procedures to be performed. • Communicate an overview of the planned scope and timing of the audit to those charged with governance. • Update and change the overall strategy and audit plan as necessary in light of new circumstances.
Engagement Characteristics	The cost reporting framework to be used. • Additional reports required, such as stand-alone operational and industry-specific requirements (by regulators, etc.). • Any need for specialized knowledge or expertise to address complex, specific, and high-risk audit areas. • Evidence required from service organizations. • Use of evidence obtained in previous cost audits (such as risk assessment procedures and tests of controls). • Effect of information technology on audit procedures (availability of data and use of computer-assisted audit

Basic Steps	Description
	techniques). • Need to introduce some unpredictability in performing cost audit procedures. • Availability of entity personnel and data.

Reporting Objectives	• Entity's timetable for reporting.
	• Timing of meetings with management and those charged with governance to discuss:
	  ○ The nature, timing, and extent of the cost audit work. This could include basis for inventory valuation, external confirmations, and interim and other required procedures,
	  ○ Status of audit work throughout the engagement, and
	  ○ The cost auditor's report and other communications such as management letters.
	• Timing of meetings/communications among engagement team members to discuss:
	  ○ Entity risk factors (business and fraud risk),
	  ○ Nature, timing, and extent of work to be performed,
	  ○ Review of work performed, and
	  ○ Other communications with third parties.

Significant Factors	• Materiality (overall, individual cost statement areas, and performance materiality).
	• Preliminary assessment of risk at the overall cost statement level and the impact on the audit.
	• Preliminary identification of:
	  ○ Significant and material items of cost, cost heads, and disclosures; and
	  ○ Areas where there may be a higher risk of material misstatement.
	• How engagement team members will be reminded to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence.
	• Relevant results of previous cost audits, including identified control deficiencies and action taken by management to address them.
	• Discussions with firm's personnel who provided other

Basic Steps	Description
	services to the entity. • Evidence of management's attitude toward internal control, and importance attached to internal control generally throughout the entity. • Volume of transactions, which may determine whether it is more efficient for the cost auditor to rely on internal control.
Significant Changes and Developments	• Significant business developments affecting the entity, including changes in information technology and business processes, changes in key management and , mergers, and diversification. • Significant industry developments, such as changes in industry regulations and new reporting requirements. • Significant changes in the cost reporting framework, such as changes in cost accounting policies. • Other significant relevant developments, such as changes in the legal environment affecting the entity. i.e product wise or product group wise.
Nature, Timing, and Extent of Resources Required	• The engagement team (including, where necessary, the engagement quality control reviewer). • Assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement. • Engagement budgeting, including considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement.

When the risks of material misstatement have been identified and assessed, the overall strategy (including timing, staffing, and supervision) can be finalized, and the detailed audit plan developed. The detailed plan will set out the further audit procedures required at the assertion level that responds to the identified and assessed risks.

As work commences, changes may be required to the overall strategy and detailed plans to respond to new circumstances, audit findings, and other information obtained. Any such changes are to be documented along with the reasons in the audit documentation, such as the overall audit strategy or audit plan.

Illustrative Format of an Audit Strategy Memo

Objectives

The purpose of this document is to share with the Audit Committee / Board of Directors of proposed audit strategy in relation to the audit of BCD Limited (the Company) of the cost statements for the year ending 31st March 20.., comprising of the quantities details of items of cost as on that date, and the Cost Sheet showing element wise as well as per unit of cost of production , Reconciliation Statement of profits & indirect taxes and Statement of value addition and distribution of earnings for the year then ended and a summary of significant accounting policies and other explanatory information.

Management Responsibility for the Cost Statements

Management is responsible for preparation and fair presentation of these cost statements in accordance with *Standards of Cost Auditing* and *Cost Accounting Standards* issued by *Institute of Cost Accountants of India*, and for such internal control as management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to error or fraud.

Our Responsibilities

Our responsibility in relation to the audit of cost statements is to provide an expression of an opinion on whether the cost statements are prepared, in all material respects, in accordance with *Generally Accepted Cost Accounting Principles* and *Cost Accounting Standards* (applicable cost reporting framework). Our cost audit is carried out in accordance with the Standards on Cost Auditing issued by the Institute of Cost Accountants of India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the cost statements are free from material misstatement and are adequate determination of cost of production / operation(s).

Our Overall Approach

An audit of cost statements involves performing audit procedures to obtain audit evidence about the cost heads, items of cost and disclosures in the cost statements. The audit procedures for this purpose depend on our judgement, including the assessment of the risks of material misstatement of the cost statements, whether due to fraud or error. An audit of cost statements also includes evaluating the appropriateness of cost accounting policies used and the reasonableness of the cost estimates made by management as well as evaluating the overall presentation of the cost statements. Our approach to the audit of cost statements is risk focused based on our understanding of the Company and its environment, including the company's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement at the cost statement level and assertion levels . We have planned to carry out audit procedures through obtaining sufficient appropriate audit evidence in relation to the assessed risks of material misstatement. As mentioned, we shall consider internal control relevant to the company's preparation and fair presentation of the cost statements however such consideration is not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. We shall communicate to you at the end of the audit of cost statement or if required during the audit about any deficiencies in internal control framework that we notice in course of our audit of cost statements however such communication shall not include all possible weaknesses in internal control that a more extensive review exercise might identify.

Discussion with Management

We have met with all the functional heads of the Company during our initial meetings at the commencement of the cost audit engagement and discussed salient features of our planning process with xxx (CFO/ CMA / Plant Head / Finance Head as appropriate). We have not yet verified the information obtained in such meetings while presenting through this document.

While developing the audit strategy, we have taken cognizance of the production / capacity / process flow / complexity of operations of the Company, its business strategies and risks and customized the audit strategy in accordance with such needs.

In course of the audit of cost statements and throughout the year, we shall closely interact with management of the Company to ensure timely responses to any emerging issues.

Use of experts / Third Party Premises

We shall use following experts on the cost audit engagement to gain sufficient appropriate evidence in relation to the respective area;

Third Party Premises

We shall visit the third party premises to study the job work done and wastages incurred of free supply of material to map abnormal and normal wastages, since the bench mark is not produced before us and the wastages are highly violate in nature.

Operations Experts

We shall use our cost auditor's expert to map the process flow / cost flow incurred and capacity determined as no previous reference is remain no longer valid due to up gradation of products and facilities.

IT Engineers

We shall use a team of IT experts to review the cost control chart / routing / internal control of the new ERP implemented during the year.

Materiality

We have determined our materiality levels as a part of our planning process and shall apply these levels throughout the audit to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the cost statement level as a whole.

Key Risks

Pursuant to the Standards on Auditing, following risks are required to be considered in all audits of cost statements:

1) Management override of controls – Generally, management remains in a position to manipulate accounting records and prepare fraudulent statements. Accordingly, the risk of management override of control is considered a key risk and we shall carry out controls testing and substantive procedures, including review of journal entries, cost accounting estimates and significant transactions that are outside the normal course of business.

2) Cost of Production / Cost of Operations - Due to the nature of business and regulatory framework in which the Company operates, we have considered this to be a key risk and we plan to perform any specific audit procedures for cost of production / cost of operation, such as performing detailed analytical procedures, extensive tests of details and visiting multiple branches of the Company.

As part of our planning we have identified the following additional key risk based on our initial discussions with management:

- New ERP Systems: - on account of the new ERP system implemented this year, we shall understand the controls embedded in the systems, re-perform and review reconciliations and also involve an IT expert team in this process.

We shall focus our attention on the aforesaid area of concern in the view of the potential elevated risks. The nature, extent and timing of audit procedures shall be appropriately adjusted depending on the risk of material misstatement assessed.

However, in course of audit, of we come across circumstances which may result in a potential risk of material misstatements, we shall change our audit procedures accordingly.

Fraud Risk Consideration

The primary responsibility for the prevention and detection of fraud rests with the Board of Directors of the company and its management. However, during the course of audit if any existence of fraud found, then it shall be reported according to requirements of Sec-143 (12) of the companies act, 2013.

We are required to consider fraud risk factors and respond to such factors in course of the audit of cost statements. While we believe the fraud risk to be low, we shall monitor the aspect of management override of control on an ongoing basis in course of our audit and update our audit approach if deemed necessary.

Independence

In accordance with the Standards on Cost Auditing, we are required to comply with ethical requirements and communicate to you all relationships between us and the Company that may have bearing on our independence. In our opinion and based on the safeguards we have put in place, we do not envisage any threats to objectivity and independence as on date.

Cost Audit Timelines

The proposed timelines as discussed with management are as follows:

Cost Audit Activity	**Timelines**
Developing audit strategy/ plan and meeting management	xxx
Commencement of fieldwork	xxx
Review by Engagement Partner/ Review Partner	xxx
Issue draft cost audit report	xxx
Clarification on cost auditor's qualification , if any	xxx
Audit Committee/ Board of Directors to approve cost statements, discuss and sign cost auditor's report	xxx

Audit Team

We have selected the audit team with requisite expertise and relevant experience as follows;

Designation	**Name**
Engagement Partner	xxx
Signing Partner / Review Partner	xxx
Senior Manager	xxx
Manager	xxx
Assistant Manager	xxx
Articles and other support staff	xxx

Audit Fees

Our proposed fee for this audit engagement is INR xxx exclusive of applicable taxes and out-of-pocket expenses (to be charged at actual).

Terms and conditions of the Engagement

We have agreed the detailed terms of the cost audit engagement with the management through our engagement letter dated XXX.

Appendix –IV

Illustrative Audit Plan

Name of Cost Auditor / Engagement Partner	
Particulars of Client M/ S ---------------------- ----------------------------- ------------------------------	
Reference No.	Date
Prepared by	
Approved by	

1. *Define Scope*

   (a)....................................
   (b)....................................

2. *Purpose of Audit (Regulatory/Non- Regulatory/ Voluntary/Mandatory)*

   (a)....................................
   (b)....................................

3. *Schedule of the Audit –*
   (Provided under Appendix IV)

   (a)....................................
   (b)....................................

4. *Timing of Communication*

   (a)....................................
   (b)....................................

5. *Engagement Terms*

   (a)....................................
   (b)....................................

6. *Management Personal*

   (a)....................................
   (b)....................................

7. *Team Planning/ Allocation of Work (Illustrated below)*

(a)………………………………
(b)………………………………

8. Result of Inquiries

(a)………………………………
(b)………………………………

9. Result of Analytical Procedures

(a)………………………………
(b)………………………………

10. Observations and Inspection

(a)………………………………
(b)………………………………

11. Information gathered in previous audit for reliance to current period

(a)………………………………
(b)………………………………

12. SWOT Analysis

I. Strength

(a)………………………………
(b)………………………………
(c)………………………………

II. Weakness

(a)………………………………
(b)………………………………
(c)………………………………

III. Opportunities

(a)………………………………
(b)………………………………
(c)………………………………

IV. Threats

(a)………………………………
(b)………………………………
(c)………………………………

13. PEST Analysis

I. **Political**

(a) Regulatory bodies & process.................................
(b) Government policies..
(c) Funding, grants, subsidies..................................

II. Economic

(a) Domestic / Overseas situation..
(b) Tax Planning specific to products & services...............................
(c) Customer/ end user driver.................................

III. Social

(a) Environmental Effects.................................
(b) Cultural Issues.................................
(c) Demographic / Market / Segment Challenges ....

IV. Technological

(a) Research & Development...............................
(b) Technological Obsolences ....
(c) ERP Systems.................................

14. Materiality Level

(a).....................................
(b).....................................

15. Evaluation of controls

(a).....................................
(b).....................................

16. Audit Procedures

(a).....................................
(b).....................................

17. Audit Evidence / Audit Findings

(a).....................................
(b).....................................

18. Written Representation

(a).....................................
(b).....................................

19. Audit Documentation

(a)......................................
(b)......................................

20. Conclusion

(a)......................................
(b)......................................

Engagement Partner
Date

Signing Partner
Date

Team Planning for Audit of Cost Statements

Name of Cost Auditor / Engagement Partner					
Particulars of Client M/ S ---------------------- ------------------------------- --------------------------------					
Reference No.			Date		
Prepared by					
Approved by					
Description	**Hours**				
	Partner / Reviewer	Senior Team Member		Junior Team Member	
		B	A	B	A
Testing of Audit Sampling / Controls					
BOM Cost					
Direct Material Cost					
Direct Labour Cost					
Power and Fuel					
Production Overhead					
Royalty					
Interest and Finance Cost					
Indirect Expenses					

Administrative Overhead					
Selling & Distribution Overhead					
Employee Cost					
Other Area					
Substantive Audit Procedures					
Inventory Valuation (WIP/ FG / RM)					
Classification of Cost					
Allocation / Absorption of Cost					
Depreciation					
Captive Consumption					
Free Supplies of Materials					
Distribution of Overheads					
Capacity Utilization					
Conversion Cost					
Revenue / Other Income					

Engagement Partner
Date

Signing Partner
Date

Illustrative format of Audit Planning Schedule

COST AUDIT PLAN: (INITIAL AUDIT)

Name of the Company:
Product(s) with CETA Headings:
Year under Audit:
Date of appointment:
Filing of CRA-2: Date of filing: SRN:

Work	Whom	Time / (days)	From... To	Remarks
First meeting with the MD/ CEO	Proprietor/ Partner in-charge	Half a day	On:	To explain the cost audit procedures and plans. To discuss and get the approval for the overall audit plan
Meeting the operating Staff	Proprietor/ Partner in-charge along with the audit manager	1 day	July 15 to July 31	Depending upon the time availability of Staff.
Plant / Unit visits	Audit Manager with the Audit assistants	1 - 2 days	August 1 to September 15	Depending upon the time availability of people.
Discussion on the company's systems and procedures-1	Proprietor/ Partner in charge with the audit team	1 day	September 15 to October 15	Internal review and this would form the basis of the depth of audit required and also the audit risk assessment procedures to be followed.
Discussion on the company's systems and procedures-2	Proprietor/ Partner in charge with the audit team	1day	October 31 to December 15	Detailed discussions with Cost Centre wise audit observations. To plan the further work and also to ensure the initial findings corroborate with the interim opinions formed.
Meetings with the unit / cost centre heads	Proprietor / Partner in-charge along with the team	1 day	December 16 to February 15	Explain the cost audit team's views and confirm that the cost statements / reports generated are up to the expectations to perform

				the audit.
Meeting with the MD / CEO	Proprietor / Partner in-charge	Half a day	February 20 to March 15	Depending upon the availability of the time of MD/ CEO to present the initial findings and also get their views and issues.
Meeting with the MD/CEO	Proprietor / Partner in-charge along with the audit manager	One hour	April 10 to May 10	Depending upon the availability of the time of MD/ CEO to understand the completion of the financial statements for the year and also the statutory audit plan. If the audit is completed, then to officially receive the financial statements along with the cost statements for the year.
Completion of Audit Meeting – 1	Audit Manager along with the team	1 - 2 days	From the date of the receipt of the cost statements	Audit progress report along with the cost statements that are checked, verified and audited with the notes and the audit findings and other details.
Completion of Audit Meeting -2	Proprietor / Partner in charge with the Audit Manager	1 day	From the date of receipt of the draft report from the team	To discuss and the proprietor / partner in charge should make the best of his judgement about the audit queries and direct the audit manager to work further wherever more detailed studies are required.
Completion of Audit 3	Proprietor / Partner in charge to meet and discuss the Key Managerial Personnel / Director	1 day	Depending upon the availability of the KMP / Director	The audit queries have to get clarified and the areas which are to be qualified should be highlighted to the KMP / Director and if they need reasonable time to explain to be offered.
Completion	Proprietor /		From the date of	Based on the details and the

of Audit 4	Partner in charge with the audit team	1 day	completion of detailed work assigned after audit 2 and also the clarifications received from the KMP / Director for the queries raised.	explanations received from the KMP / Director the audit report should be completed in all aspects and released to the company along with the bill for the services as per the appointment letter.

COST AUDIT PLAN: (SUBSEQUENT AUDIT)

- Name of the Company:
- Product(s) with CETA Headings:
- Year under Audit:
- Date of appointment:
- Filing of CRA-2: Date of filing: SRN:

Work	Whom	Time (days)	From... To	Remarks
Meetings with the unit / cost centre heads	Proprietor / Partner in-charge along with the team	One day	December 16 to February 15	Explain the cost audit teams views and confirm that the cost statements / reports generated are up to the expectations to perform the audit.
Meeting with the MD / CEO	Proprietor / Partner in-charge	Half a day	February 20 to March 15	Depending upon the availability of the time of MD/ CEO to present the initial findings and also get their views and issues.
Meeting with the MD/CEO	Proprietor / Partner in-charge along with the audit manager	One hour	April 10 to May 10	Depending upon the availability of the time of MD/ CEO to understand the completion of the financial statements for the year and also the statutory audit plan. If the audit is completed, then to officially receive the financial statements along with the cost statements for the year.
Completion of Audit Meeting - 1	Audit Manager along with the team	2 days	From the date of the receipt of the cost statements	Audit Progress report along with the cost statements that are checked, verified and audited with the notes and the audit findings and other details.
Completion of Audit Meeting – 2	Proprietor / Partner in charge with the Audit Manager	5	From the date of receipt of the draft report from the team	They have to discuss and the proprietor / partner in charge should make the best of his judgement about the audit queries and direct the audit manager to work further wherever more detailed studies

				are required.
Completion of Audit Meeting – 3	Proprietor / Partner in charge to meet and discuss the Key Managerial Personnel / Director	1 day	Depending upon the availability of the KMP / Director	The audit queries have to get clarified and the areas which are to be qualified should be highlighted to the KMP / Director and if they need reasonable time to explain to be offered.
Completion of Audit Meeting – 4	Proprietor / Partner in charge with the audit team	1 day	From the date of completion of detailed work assigned after audit 2 and also the clarifications received from the KMP / Director for the queries raised.	Based on the details and the explanations received from the KMP / Director the audit report should be completed in all aspects and released to the company along with the bill for the services as per the appointment letter.

Note: In case of change of Audit Team from Previous Year, additional meetings / plans with Clients team will be required.

Appendix - V

Illustrative Checklist for Audit of Cost Statement

The Checklist outlined below helps to ensure that the audit of cost statements is conducted in systematic and comprehensive manner and adequate evidence obtained and documentation done. It can also provide a means of communication and a place to record data for use for future reference.

The outlined illustrative checklist is framed for the purpose of verification of Items of cost, Cost heads, Costing Approach, Costing Policies, Application of Cost Accounting Standards, Transactions and Disclosures. However, the specific guidance for adherence of Standards on Cost Auditing and its interrelated requirements / check and balances are provided in various chapters of this implementation guide.

Cost Accounting Policy

S No	Particulars	Documentation/ Working Paper	Remarks
1	Identification of Cost Centre / Cost object and Cost Driver		
2	Method of Classification of Cost		
3	Method of Accounting, Allocation , Absorption and Apportionment of Cost		
4	Accounting for Material Cost including Packing Materials, Stores and Spares etc. Employee Cost, Utilities and other relevant Cost Component		
5	Cost Structure, Cost Heads and Disclosures		
6	Method of determining Cost Estimates, Cost Accumulation		
7	Accounting for By-products / Joint products, Scraps, Wastages etc.		
8	Method of attributing Direct Cost		
9	Basis and Method of Valuation of Inventory		
10	Treatment of abnormal and non recurring costs including classification of non –cost item		
11	Accounting for Depreciation / Amortization		

12	Methodology for valuation of Inter Unit / Inter Company and Related Party Transactions		

General Purpose Checklist

S No.	Particulars	Remarks
1	Production Planning and Control	
2	Manufacturing Process / Routing / Process Flow	
3	Factory Layout / No of Plant / Store / Captive Power / Blue Print of Production Area with Machine Locations	
4	Product Details / Services / Job work – Different types of Grade or Different Products / Services Manufactured / Rendered	
5	Joint Product / By Product / Captive Consumption / Self Manufactured Assets / Contract / Product Manufactured under Technical Collaboration, Licence or Lease Agreement	
6	Production Plan / Scheduling / Operating Cycle	
7	Plant Capacities	
8	Power Plant / Steam Generation / Gas Plant / Other Facilities	
9	Accounting System / Integrated Accounting / Cost Records	
10	Internal Control / IT Controls/ Authorizations	
11	MIS/ Budget Control / Forecast / Variance Analysis /Costing Approach /	
12	List of Cost Centre / Profit Centre / Revenue Centre / Business Area	
13	Regulatory Requirement / Tax Returns / Environmental / Quality/ Compliances etc.	
14	Chart of Accounts / General Ledger Mapping / Costing Run	
15	Statutory Audit Report / Internal Audit Report / Management Audit Report / Process Audit Report / Operational Audit Report, Other Audit Report	
16	Standards Operating Procedures (SOP) / Company Standard Policy (CSP) & Rules	
17	Pricing Policy / Transfer Pricing Policy	
18	Corporate Social Responsibility (CSR)	

19	Capital Expenditure / Project Status / Strategic Alliances	
20	Planned / Preventive Maintenances	
21	BOM Cost / Standards Raw Material Composition / Process Chemicals / Indirect Material /	
22	Details of Packing Materials, types of packing , stocking units.	
23	Details of Utilities, Services Separately for each type of utility like Raw water, DM water, Steam, Power, Compressed Air etc.	
24	Details of Pollution Control Measures / Effluent Treatment etc.	
25	Selling and Distribution Channel / Product Exported / Export Incentives, if any.	
26	Organizational Structure / Audit Committee / Board of Directors/ Hierarchy Chart	

Illustrative Data required for the Audit Period

S No.	Particulars	Remarks
1	B/S and P/L with Schedules and Trial Balance	
2	Details of Inventories – Quantity and Value	
3	Details of Raw Material Consumed including Process Material / Chemicals Consumption; details with receipt and issue both in quantity and value for individual products	
4	Packing Material Details both in Quantity and Value for individual products	
5	Quantitative Details of Product (individually) from raw material issue to final conversion, work in progress (product wise), at each stage of production / operations	
6	Scrap generated (stage wise), Scrap Recycled in production process, any quantitative adjustments thereof	
7	Details of utilities / Self Generated – Procured / Consumed by user department (department wise / cost centre wise)	
8	Cost Centre wise expense analysis in respect of individual heads of expenses	
9	Cost Centre wise machine utilization / product wise running hours , down time (normal or abnormal both)	
10	Quantitative Production / Product Wise Sales Analysis (Domestic and Exports)	

11	Statutory Returns of Indirect Taxes or Direct taxes (if require)	

CAS -1 Classification of Cost

S No	Particulars	Documentation/Working Paper	Remarks
1	Basis of Classification (i) Nature of Expenses (ii) Relations to object- traceability (iii) Functions / Activities (iv) Behaviours –Fixed, Semi or Variables (v) Management Decision Making (vi) Production Process (vii) Time Period		
2	Whether the grouping of cost centre under cost heads based on their classification are adequate? If yes, whether there is consistent approach followed in classification of costs / cost centres?		

CAS-2 Capacity Determination

S No	Particulars	Documentation/ Working Paper	Remarks
Determination of Capacity			
1	Whether Capacity is determined on the following basis; (a) units of production or (b) equivalent machine or (c) man hours		
2	Whether the Installed capacity is determined based on (a) Manufacturers' technical specifications; (b) Technical Evaluation (c) Capacities of individual or interrelated production or operation centres;		

	(d) Operational constraints or capacity of critical machines or equipment; or (e) Number of shifts or machine hours or man hours		
3	Whether technical experts are considered/ used for assessment of installed capacity under ideal conditions, where technical specifications of facilities are not available?		
4	Whether the capacity is assessed as per directions of government or regulator? If yes, whether stipulated directives by government or regulator are followed?		
5	Whether any addition or discountenance to production facility is made? If yes, whether installed capacity is reassessed from the date of such addition or discontinuance?		
6	Whether there is any improvement in the production process? If yes, whether the installed capacity is reassessed from the date of such improvement?		
7	Whether normal capacity is determined after making the following adjustments? (a) Holidays, normal shut down days and normal idle time; (b) Normal time lost in batch change over; (c) Time lost due to preventive maintenance or planned maintenance; (d) Loss in efficiency due to ageing of the equipment; or (e) Number of shifts or machine house or man hours;		
8	Whether any other adjustments are also made according to nature or usages of machinery or usages? if yes, please specify such adjustments with reasons.		
Disclosures			
9	Whether cost statements disclosed the following;		

	• Basis for arriving at different types of capacity? • Changed in installed capacity or normal capacity with reason thereof? • Capacity enhanced through outsourcing? • Capacity outsourced to others? • Details of actual production of goods or services provided • Self manufactured goods or services provided through in house facility? • Goods produced or services provided through outsourcing? • Reasons for low capacity utilization, if any. • Abnormal cost due to under utilization of capacity.		
10	Whether the disclosures made are significant, material and quantifiable?		
11	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		

CAS-3 Production and Operation Overheads

S No	Particulars	Documentation/ Working Paper	Remarks
Principles of Measurement			
1	Whether proper records are maintained for various items of P & O overheads? Whether such overheads representing procurement of resources is determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts(other than cash discount), duties and taxes refunded or to be credited?		
2	Whether there is a consistent basis of computation of P & O overheads?		

3	Whether any abnormal costs form part of such overheads and whether such abnormal costs are material and quantifiable?		
4	Whether overhead cost includes finance cost or imputed cost?		
5	Whether standard costing is followed? If yes, whether overhead variances attributable to abnormal reasons are excluded from P & O cost?		
6	Whether such costs are classified on the basis of behaviour i.e. Variable, Semi Variable or Fixed overheads or any other basis are adopted? If any other basis is adopted, a brief write up is obtained for doing the same.		
7	Whether any subsidy or grant or incentive or amount-of similar nature, if received with respect to P & O overheads is credited to such overheads?		
8	Whether fines, penalties, damages and similar levies paid to statutory authorities or other third parties are excluded form P & O overheads?		
9	Whether credits or recoveries relating to the overheads are deducted from the total overhead to arrive at the net overheads?		
10	Whether any change in the cost accounting principles applied for the measurement of the overhead in the current Audit Period? If yes, whether it is required by law or compliances or change would result in better presentation?		
Assignment of Cost			
11	Whether there is functional classification of overheads?		
12	Whether there are adequate basis of assignment of overheads to the cost objects?		
13	Whether variable or operation overheads		

	are absorbed to products or services based on actual production?		
14	Whether fixed or operation overheads is based on normal capacity?		
Disclosure			
15	Whether cost statements disclosed the following in relation to Production and Operation Overheads: → Basis of assignment of Production and Operation Overheads to the cost objects; → P & O overheads incurred in foreign exchange; → P & O overheads relating to resources received from or supplied to related parties; → Subsidy/Grants/Incentives or any amount of similar nature received or receivable reduced from P & O overheads; → Credit or recoveries relating to P & O overheads; → Abnormal cost not included in P & O overheads; → Unabsorbed P & O Overheads.		
16	Whether the disclosures made are significant, material and quantifiable?		
17	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
18	Whether any significant changes made in the cost accounting policy and methods applied which have material effect on Production & Operation overheads are disclosed?		

CAS-4 Captive Consumption

S No	Particulars	Documentation/ Working Paper	Remarks
Determination of Cost of Production			
1	Whether proper records are maintained showing the quantity and cost of each such goods or services transferred to other departments or cost centres or units of the company for self-consumption and sold to outside parties separately?		
2	Whether Material consumed includes the materials directly identified such as follows: (a) indigenous materials (b) imported materials (c) bought out items (d) self manufactured items (e) process materials and other items		
3	Whether cost of material consumed consist of cost of material, duties and taxes, freight inwards, insurance and other expenditure directly attributable to procurement? Whether trade discount, rebates and other similar items,Cenvat credit, credit for countervailing customs duty, Sales Tax set off, VAT, duty draw back and other similar duties subsequently recovered/ recoverable are deducted?		
4	Whether direct wages and salaries include house rent allowance, overtime and incentive payments made to employee directly engaged in the manufacturing activities?		
5	Whether direct wages and salaries include fringe benefits such as; - Contribution to provident fund and ESIS; - Bonus / Ex-gratia payments to		

	employee - Provision for retirement benefits such as gratuity and superannuation - Medical benefits - Subsidised food - Leave with pay and holiday payments - Leave encashment - Other allowances such as Child allowances, Conveyance, which are payable to employees in the normal course of business?		
6	Whether direct expenses are the expenses other than direct material cost and direct employees costs which can be identified with the product?		
7	Whether direct expenses included - Cost of utilities such as fuel, power, water, steam etc? - Royalty based on production - Technical Assistance / know how fee - Amortized cost of modules, pattern and patents etc - Job Charge - Hire charge for tools and equipments - Charges for a particular product designing etc.		
8	Whether works overheads are the indirect costs incurred in the production process?		
9	Whether works overheads include the following expenses: ▪ Consumable stores and spares ▪ Depreciation of plant and machinery, factory building etc. ▪ Lease rent of production assets ▪ Repair and maintenance of plan and machinery, factory building etc.		

	▪ Indirect employees cost connected with production activities ▪ Drawing and Designing department cost. ▪ Insurance of plant and machinery, factory building, stock of raw material & WIP etc. ▪ Amortized cost of jigs, fixtures, tooling etc. ▪ Service department cost such as tool room, Engineering & Maintenance, Pollution control etc.		
10	Whether quality control cost incurred relating to quality control activities for adhering to quality standards? Whether such expense includes salaries & wages relating to employee engaged in quality control activity?		
11	Whether R & D cost incurred for development and improvement of the process or existing product is included in the cost of production?		
12	Whether administrative overheads analysed in relation of production and other activities? Whether administrative overheads in relation to production activities are included in the cost of production?		
13	Whether administrative overheads in relation to activities other than manufacturing activities e.g. marketing, projects management, corporate office expenses, etc. excluded from the cost of production?		
14	Whether cost of packing is included when such product is transferred / dispatched duly packed for active consumption?		
15	Whether packing cost includes both cost		

	of primary and secondary packing required for transfer/ dispatch of goods used for captive consumption?		
16	Whether overheads is analysed into variable overheads and fixed overheads?		
17	Whether variable overheads are the item which change in the volume of production, such as cost of utilities?		
18	Whether variable production overheads are absorbed in production cost based on actual capacity utilisation?		
19	Whether fixed overheads and other similar item of fixed cost such as a) Quality control cost b) Research and development costs c) Administrative overheads d) Relating to manufacturing are absorbed in the production cost on the basis of the normal capacity or actual capacity utilization of the plant, whichever is higher?		
20	Whether Stock of work-in-progress is valued at cost on the basis of stages of completion as per the cost accounting principles? Whether, stock of finished goods is valued at cost? Whether opening and closing stock of work-in-progress is adjusted for calculation of cost of goods produced and similarly whether opening and closing stock of finished goods is adjusted for calculation of goods despatched?		
21	Whether production process result in more than one product being produced simultaneously? Whetherjoint costs are allocated between the joint products on a rational and consistent basis?		

	Whether the net realisable value of by-products is credited to the cost of production of the main product?		
22	Whether the joint cost are allocated to joint products based on the sales values of products at the split off point?		
23	Whether production process generate scrap or waste? if yes, whether realized or realizable value of scrap or waste is credited to the cost of production?		
24	Whether scrap or waste does not have ready market and same is used for reprocessing? Whether scrap or waste value is taken at a rate of input cost depending upon the stage at which such scrap or waste is recycled? Whether expenses incurred for making the scrap suitable for reprocessing are deducted from value of scrap or waste?		
25	Whether miscellaneous income relating to production adjusted in the calculation of cost of production?		
26	Whether input material, either or both direct or indirect nature, including packing material supplied free of cost by the user of the captive product? If yes, whether landed cost of such material included in the cost of production?		
27	Whether amortization cost of such items included in the cost of production?		
28	Whether Interest and financial charges being a financial charge excluded from part of cost of production?		
29	Whether abnormal and non-recurring cost arising due to unusual or unexpected occurrence of events, such as heavy break down of plants, accident,		

	market condition restricting sales below normal level, abnormal idle capacity, abnormal process loss, abnormal scrap and wastage, payments like VRS, retrenchment compensation, lay-off wages etc. excluded from cost of production?		
Disclosure			
30	Whether any change made in the cost accounting principles and practices during the concerned period which may materially affect the cost of production in terms of comparability with previous periods disclosed?		
31	Whether the fact that opening and closing stock of work-in-progress and finished goods are not readily available for certification purpose disclosed?		

CAS-5 Transportation Cost

S No	Particulars	Documentation/ Working Paper	Remarks
Maintenance of records for ascertaining Transportation Cost			
1	Whether proper records are maintained for recording the actual cost of transportation showing each element of cost?		
2	Whether abnormal costs relating to transportation, if any recorded and excluded for computation of average transportation cost?		
3	Whether the company is having its own transport fleet? If yes, whether proper records are maintained to determine the actual operating cost of vehicles showing details of various elements of cost, such as salaries and wages of driver, cleaners and others, cost or fuel, lubricant grease, amortized cost of tyres and battery, repairs and maintenance, depreciation of the vehicles, distance covered and trips made, goods hauled		

	and transported to the depot?		
4	Whether the company is hiring transport services from outside? If yes, whether records are maintained for charges incurred for - despatch of goods, - date of despatch, - type of transport used, - description of the goods, - destination of buyer, - name of consignee, - challan number, - quantity of goods in terms of weight or volume, - distance Involved, and - amount paid and other related details?		
5	Whether separate records maintained for inward and outward transportation cost specifying the details particulars of goods despatched, name of supplier or recipient, amount of freight, etc?		
6	Whether records for transportation cost from factory to depot and thereafter maintained separately?		
7	Whether records for transportation cost or carrying any material or product to job-workers place and back maintained separately?		
8	Whether records for transportation cost for goods involved exclusively for trading activities maintained separately?		
9	Whether records of transportation cost directly allocable to a particular category of products maintained separately? Whether their allocation made is included in transaction value of product?		
10	Whether proper records maintained for common transportation cost, both for own fleet or hired ones?		
11	Whether separate records for transportation		

	cost for exempted goods, excisable goods cleared for export maintained?		
12	Whether separate records of cost for mode of transportation other than road like ship or air maintained?		
Treatment of Cost			
13	Whether inward transportation costs are included in cost of procurement of materials? Whether such inward cost is properly identified for proper allocation / apportionment to the materials / products?		
14	Whether outward transportation cost is included while calculating cost of sales?		
15	Whether consistent and appropriate unit of measurement used for allocation of transportation cost ?		
16	Whether there is any change in the basis of apportionment of Transportation cost? Whether following basis are used in order of priority for apportionment of outward transportation cost depending upon the nature of products, unit of measurement followed and type of transport used: (i) Weight (ii) Volume of goods (iii) Tonne –KM (iv) Unit/ Equivalent unit (v) Value of goods (vi) % of usage of space		
17	Whether distance is factored while determining the transportation cost per unit?		
18	Whether abnormal and non recurring cost is excluded from transportation cost?		
19	Whether the cost sheet defined in appendix-1 of the SCA is followed?		

CAS -6 Material Cost

S No	Particulars	Documentation/ Working Paper	Remarks
General Purpose Checklist			
	• Whether the system of accounting of Material (Stores Ledger) - Computerized or manual? • If Computerised - Detail of Software, Which platform - Tally or Oracle or SAP etc.? • What is the method of Valuation of issue / receipt of inventory? • Whether test check is done on Raw Material, Consumables, Packing Material etc. in the system? • What procedures is used for issuing the material – Individual slips or Bill of Materials (BOM)? • Whether test check done on valuation of receipt, separately for imported and indigenous items? • Whether input – output ratio is cross verified? • In case of process costing – whether any reconciliation of output of one process with input of next process done?		
Principle of Measurement			
1	Does the company maintains proper records showing separately all receipts, issues and balances both in quantities and cost of each item of raw material required for the production of goods or rendering of services?		
2	Whether material receipt has been valued after including - purchase price including duties and taxes, - freight inwards, - insurance, and - other expenditure directly attributable to procurement that can be quantified with		

	reasonable accuracy		
3	Whether material receipt has been valued after excluding - Finance Cost - Trade Discounts (Cash Discounts being a financial income is not to be net off) - Rebates - Taxes & duties refundable or to be credited by the taxing authorities if no, than provide a brief write up on the system followed?		
4	Whether Self-manufactured materials or captive consumption has been valued including: - direct material cost, - direct employee cost, - direct expenses, - factory overheads, - share of administrative overheads relating to production but excludes - share of other administrative overheads, - finance cost and - marketing overheads if no, than provide a brief write up on the system followed ?		
5	Whether the spares or tools kept for specific use by equipment are capitalised with that specific equipment? Whether the cost of capital spares or insurance spares, whether procured with the equipment or subsequently, amortised over a period not exceeding the useful life of the equipment?		
6	Whether the normal loss or spoilage of material prior to reaching the factory or at places where the services are provided are absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal?		
7	Whether the losses due to shrinkage or evaporation and gain due to elongation or		

	absorption of moisture etc., before the material is received has been absorbed in material cost, with corresponding adjustment in the quantity?		
8	Whether the forex component of imported material cost has been converted at the rate on the date of the transaction?		
9	Whether subsequent change if any in the exchange rate till payment or otherwise has formed part of the material cost? If yes, than provide the brief write up for doing same and reversal date?		
10	Whether any demurrage or detention charges, or penalty levied by transport or other authorities are not formed part of the cost of materials?		
11	Whether subsidy or grant or incentive and any such payment (if received) with respect to any material has been credited to the such cost? If no, brief write up for not following the same and reversal date?		
12	Whether the method of valuation of issues of materials is followed on a consistent basis? Also indicate the basis followed and method of valuation?		
13	Whether the material cost is valued at standard cost? If yes, whether the price variance is treated as part of material cost?		
14	Whether any abnormal cost is included in material cost?		
15	Wherever, material costs include transportation costs, determined as per CAS-5?		
16	Whether the material cost included any imputed cost? if yes, provide a brief write for reason of recording the same?		
17	Whether there is any self manufactured component or sub assemblies included in material cost? Whether same are valued as per the principle stipulated in CAS-4 “Cost of Production for		

	Captive Consumption"?		
18	Whether the material cost includes cost of normal scrap or defectives? Whether the costs of abnormal scrap or defectives are included in material cost? If no, then what is the treatment given? Whether amount recovered through realizable value credited to abnormal loss?		
Assignment of Costs			
19	What is the basis of allocation of material cost to the cost objects? Whether the basis adopted are economically feasible or assigned to the cost object on the basis of material quantity consumed or similar identifiable measure and valued as per the principle laid under in CAS-6 "Material Cost"?		
20	Whether the materials not directly traceable to the cost objects are assigned on suitable basis i.e. technical estimates.		
21	Whether material is manufactured on Job work or by third party? Whether such job work charges / processing charges payable to the third party are treated as part of material cost?		
22	Whether any part of manufacturing process is subcontracted? Whether the subcontracting charges relating to materials has been treated as direct expenses and also assigned directly to cost object?		
23	Whether there is any basis of assignment of indirect materials to the cost objects?		
24	Whether the cost of catalysts, dies, tools, moulds, patterns, etc, related to production are amortised over a period of time over the production units?		
25	Whether the cost of indirect materials with life exceeding one year has been included in cost over the useful life of the materials?		
Disclosures			

26	Whether the quantity and rates of major items of materials (above 5%) disclosed appropriately?		
27	Whether basis of valuation of materials disclosed?		
28	Whether any changes made in the cost accounting policy and methods applied which has material effect on material cost disclosed?		
29	Whether the following cost are disclosed separately? - Abnormal cost - any demurrage or detention charges, penalty levied by transport or other authorities excluded from material cost - Cost of material procured from related parties - Imputed cost in arriving material cost - Subsidy / Grants / Incentives or any such payment reduced from material cost		
30	Whether the disclosures made are significant, material and quantifiable?		
31	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		

CAS-7 Employee Cost

S No	Particulars	Documentation/ Working Paper	Remarks
General Purpose Checklist			
	➢ What is the basis of categorising Direct Employees and Indirect Employees? ➢ Whether the cost centre wise tracking of employees cost is in the system? ➢ Whether the payment mad to temporary and contractual employee booked cost centre wise? ➢ Whether system of idle time tacking and		

	accounting maintained? ➢ Whether there is any Employee labour hour rates available? ➢ Whether any costing system used for labour efficiency? If so details of the same?		
Principle of Measurement			
1	Whether proper records are maintained in respect of employee costs in such a manner as to enable the company to book these expenses cost centre wise or department wise with reference to goods or services under reference? Whether there is a consistent basis for allocation of common cost?		
2	Whether the employee cost includes Gross pay including all allowances payable along with the cost to the employer of all benefits including bonus and ex-gratia?		
3	Whether remuneration to Executive Directors made part of employee cost? Whether remuneration to Non Executive directors made part of employee cost? If yes, please provide a brief write up and reversal date?		
4	Whether the separation costs related to VRS, retrenchment, termination etc. amortised over the period benefitting from such costs?		
5	Whether there is any imputed cost forming part of employee cost? If yes, please provide a brief write up and reversal date?		
6	Does the company ascertain cost of Idle time of employees?		
7	Whether standard costing system followed? If yes, whether the normal variance in employee cost treated as part of employee cost? Whether variances due to abnormal reasons excluded from cost? Whether standard costing consistently applied in computing employee cost?		

8	Whether any subsidy/ grant or incentive (if received) with respect to employee cost credited to such cost?		
9	Whether any abnormal cost is forming part of employee cost? If yes, basis of the same and reversal date?		
10	Whether penalties, damages paid to statutory authorities or other third parties forms part of the employee cost?		
11	Whether benefits provided to an employee determined at the total cost of all resources consumed in providing such benefits like cost of free housing, free conveyance and any other similar benefits?		
12	Whether the recoveries from employees towards any benefit provided like- housing, transport, etc been reduced from the employee cost?		
13	Whether any change in cost accounting polices applied for determination of Employee Cost? Whether such change complies with the requirement of law or cost account8ng standards? Whether such changes results in appropriate preparation or presentation of cost statements?		
Assignment of Costs			
14	Whether the employee cost are traceable to cost object?		
15	Whether any change made in the cost accounting principles applied for determination of employee cost in the current Audit period?		
16	Whether there is a basis of assigning direct employee cost to cost centres/departments? Whether such basis are consistently followed i.e. Time consumed, No. of employees, Other related basis? Whether the principle of materiality adhered to while determining the employee cost?		
17	Whether there is a basis of assigning indirect		

	employee cost to cost centres/departments? Whether the suitable basis is adopted like estimate of time based on time study?		
18	Whether the amortised separation cost made part of indirect employee cost and assigned in appropriate manner? Whether the unamortised part of amount related to discontinue operations made part of non-cost?		
19	Whether the costs relating to recruitment, training and other such costs made part of overheads?		
20	Whether the Overtime premium assigned directly to the cost object or whether it is treated as overheads? Whether Idle time cost assigned direct to the cost object or whether it is treated as overheads?		
Disclosures			
21	Whether costs statements disclose the following: - Employee cost attributable to capital works or jobs in the nature of deferred revenue expenditure - Separation Cost - Abnormal Cost - Penalties and damages - Subsidy, grant, Incentives and any such other payment - Employee cost paid to Related Parties - Employee cost incurred in foreign exchange		
22	Whether any changes made in the cost accounting policy and methods applied which has material effect on material cost are disclosed?		
23	Whether the disclosures made are significant, material and quantifiable?		
24	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost		

	statements		

CAS-8 Cost of Utilities

S No	Particulars	Documentation/ Working Paper	Remarks
General Purpose Checklist			
	• Whether all utilities i.e. Power, Water, Compressor, Boiler and Steam etc.are separately measured? • Whether source of power, units generated from each source and their consumption, cost centre wise properly recorded? • Whether source of water – cost and utilisation data properly captured? • Whether cost centre wise data booked properly? • Check whether the treatment of Inter-unit transfer, Inter-state sale are captured properly? • Check process and data on inter-utility transformation like water used in steam etc.		
Principle of Measurement			
1	Whether proper records maintained for purchase, generation, and consumption of various Utilities treating each utility as a distinct cost object? Whether consumption records available cost center wise?		
2	Whether cost of Utilities purchased includeduties & taxes, transportation cost, insurance and other expenditure directly attributable to cost (net of trade discount)?		
3	Whether different methods adopted for computing cost of (a) Utilities consumed Captivity (b) Utilities transferred to inter unit (c) Utilities transferred to companies within the same group (inter-company)		

	(d) Utilities sold to third(outside) parties		
4	Whether finance costs incurred in connection with the utilities excluded from cost of utilities?		
5	Whether cost of utilities includes the cost of distribution of such utilities? Whether cost of distribution includes cost of delivery up to the point of consumption?		
6	Whether cost of utilities excludes imputed costs?		
7	Whether price variance related to cost of utilities included in cost of utilities where standard costing is followed? Whether such price variance caused due to normal variance in utility cost? Whether variances due to abnormal reasons excluded from cost?		
8	Whether subsidy/ grants or incentives (if received) in respect of Utilities credited to the cost of related utilities?		
9	Whether cost of production and distribution of utilities determined based on the higher of normal capacity or actual capacity utilisation? Whether unabsorbed cost treated as abnormal cost? Whether cost of stand-by utilities included in committed cost of maintaining such utility?		
10	Whether any abnormal cost which is material and quantifiable is forming part of the cost of utilities?		
11	Whether penalties, damages paid to statutory authorities or other third parties excluded from cost of utilities?		
12	Whether credits or recoveries relating to the utilities deducted from the total cost of utility to arrive at the net cost of utility?		
13	Whether any changes made in the cost accounting principle applied for measurement of cost of utilities? Whether such change complies with the		

	requirement of law or cost accounting standards? Whether such changes results in appropriate preparation or presentation of cost statements?		
Assignment of Costs			
14	Whether there is any basis of assigning the cost of utility to the cost centre / cost objects?		
15	Whether the utilities cost traceable to cost object?		
16	Whether the utilities cost not directly traceable to cost object assigned on most appropriate basis?		
17	Whether the most appropriate basis of cost of distribution of a utility to the departments consuming service is derived from usage parameter?		
Disclosures			
18	Whether cost statements disclosed the following in relation to cost of utilities: - Basis of distribution to the consuming centres - Cost of purchase, production, distribution, marketing, and price with reference to sales to outside parties? - If standard costing method is used, the price and usage variances - Cost and price of utility received from/ supplied to related parties - Cost and price of utility received from/ supplied to Inter unit and Inter Company Transfers - Cost incurred in foreign exchanges - Subsidy/ Grant/ Incentives and any such payment reduced from cost - Credits / recoveries net off from cost of utilities - Abnormal cost excluded - Penalties and damages paid excluded from cost of utilities		

19	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on cost of utilities disclosed?		
20	Whether the disclosures made are significant, material and quantifiable?		
21	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		

CAS-9 Packing Material Cost

S No.	Particulars	Documentation/ Working Paper	Remarks
Principle of Measurement			
1	Whether proper records (specifying the quantity and cost of various packing materials and other expenses incurred on primary and secondary packing) maintained for domestic and export separately?		
2	Whether the packing material receipts valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified at the time of acquisition?		
3	Whether finance costs directly incurred in connection with the acquisition of packing material excluded from packing material cost?		
4	Whether self manufactured packing material value includes direct material cost, direct employee cost, direct expenses, job charges, factory overheads including share of administrative overheads comprising factory management and administration and share of research and development cost incurred for		

	development and improvement of existing process or product?		
5	Whether the valuation of captive consumption of packing material is in accordance with Para 5 (principles defined for determination of cost of production for captive consumption) of CAS-4?		
6	Whether normal loss or spoilage of packing material prior to receipt in the factory absorbed in the cost of balance material (net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal)?		
7	Whether forex component in imported packing material cost valued at therate on the date of transaction? Whether any subsequent change in exchange rate considered or not?		
8	Whether demurrage, detention charges or penalty levied by the transport agency or any authority excluded from cost of packing materials?		
9	Whether any subsidy or grant or incentive or any such payment (if received) with respect to packing material credited for ascertainment of such cost?		
10	Whether principle of valuation of issue of packing material is consistently followed? Whether method of valuation consistently followed?		
11	Whether packing material costs include transportation costs? Whether such transportation cost is determined on as per the principle laid down in CAS-5?		
12	Whether imputed costs excluded while determining packing material cost?		
13	Whether price variances related to packing materials and portion of usage variances due to normal reasons included in packing material cost wherever packing materials are accounted		

	at standard cost? Whether usage variances due to abnormal reason treated as a part of abnormal cost?		
14	Whether normal loss arising from the issue or consumption of packing materials included in the packing materials cost?		
15	Whether any abnormal cost where it is material and quantifiable excluded while determining packing material cost?		
16	Whether credits or recoveries in the nature of normal scrap arising from packing materials deducted from the total cost of packing materials?		
Assignment of Costs			
17	Whether cost of Packing material directly assigned to cost object to the extent it is economically feasible?		
18	Whether the cost of primary packing materials assigned on the basis of the quantity consumed or similar measures like technical estimates?		
19	Whether the cost of reusable packing materials is part of distribution overheads? Whether cost of reusable assigned on the basis taking into account the number of times or period over which it is expected to be reused?		
Disclosure			
20	Whether the cost statements disclosed the following : - Basis of valuation of Packing Materials - Standard cost of Packing Material, the price variance and usage variance - Cost and price of Packing Material received from/ supplied to related parties - Packing Material cost incurred in foreign exchange - Subsidy/ Grant / Incentives and any such payment reduced from Packing Material Costs		

	- Credit / Recoveries related to Packing Cost - Abnormal cost excluded from Packing cost - Penalties and damages paid etc. excluded from Packing Material Cost		
21	Whether the disclosures made are significant, material and quantifiable?		
22	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		

CAS- 10 Direct Expenses

S No	Particulars	Documentation/ Working Paper	Remarks
Principles of Measurement			
1	Whether proper records maintained in respect of direct expenses? Whether the record maintained are in a manner as to enable the company to book these expenses cost centre wise or cost object or department wise?		
2	Whether any direct expenses incurred for the use of bought out resources determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto, after net of trade discounts, rebates, taxes and duties refundable or to be credited? If no, provide write up on the system followed?		
3	Whether other direct expenses than mentioned above in point. 2 are determined on the basis of amount incurred in connection therewith?		
4	Whether direct expenses paid or incurred in lump-sum or onetime payment settlement is amortized on the basis of estimated output or benefit derived?		

5	Whether an item of direct expenses meets thetest of materiality? If yes, whether it is treated as part of overheads?		
6	Whether finance costs incurred in connection with the self generation or procured resources excluded from Direct expenses? Whether imputed costs included in direct expenses?		
7	Whether standard costing is followed? If yes, whether the normal variances in direct expenses treated as part of such expenses? Whether variances due to abnormal reasons excluded from direct expenses?		
8	Whether subsidy or grant or incentive or any such payment (if received) with respect to any direct expenses has been credited to such cost?		
9	Whether any abnormal portions of the direct expenses are part of the direct expenses?		
10	Whether Penalties, damages paid to statutory authorities or other third parties form part of the direct expenses?		
11	Whether any credits or recoveries related to the direct exp, deducted from direct expenses?		
12	Whether any changes are made in the cost accounting principle applied for measurement of the direct expenses? Whether such change complies with the requirement of law or cost accounting standards? Whether such changes results in appropriate preparation or presentation of cost statements ?		
Assignment of Cost			
13	Whether there is any basis of assigning the direct expenses to the cost centre / cost objects?		
14	Whether the direct expenses are traceable to cost object?		
Disclosures			

15	Whether cost statements disclosed the following in relation to direct expenses: - Basis of distribution to the cost object/ cost units / cost centre - Quantity & rates of items of direct expenses - Standard Cost of Direct expenses, and the price and usage variance - Procurement of resources and expenses incurred in connection with resources generated - Paid / Payable to related parties - Expenses incurred in foreign exchange - Subsidy/ grant / incentive and any such payment reduced from direct expenses - Credit / recoveries relating to direct expenses - Abnormal portion of direct expenses - Penalties and damages excluded from the direct expenses		
16	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on direct expenses disclosed?		
17	Whether the disclosures made are significant, material and quantifiable?		
18	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		

CAS -11 Administrative Overhead

S No	Particulars	Documentation/ Working Paper	Remarks
Principle of Measurement			
1	Whether there is a consistent method of determination of Administrative overheads?		
2	Whether the company follow different treatment for operating lease and financial lease? Whether the operating lease is included under		

	administrative overheads? Whether the financial lease is treated as finance cost?		
3	Whether the cost of software (developed in house, purchased, licensed or customised), including up-gradation cost are amortised over its estimated useful life?		
4	Whether cost of administrative services procured from outside is determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discount (other than cash discount), taxes and duties refundable or to be credited?		
5	Whether any subsidy or grant or incentives or any amount or similar nature (if received) with respect to Administrative overheads is credited to such cost?		
6	Whether administrative overheads include any abnormal administrative cost?		
7	Whether fines, penalties, damages and similar levies paid to statutory authorities or other third parties are excluded from the administrative overheads?		
8	Whether any changes in cost accounting principle applied for measurement of the administrative overhead? Whether such change complies with the requirement of law or cost accounting standards? Whether such changes results in appropriate preparation or presentation of cost statements?		
Assignment of Cost			
9	Whether there is any method for tracing of the Administrative overheads to cost centre / cost objects?		
10	Whether while assigning admin overheads, cause and effect or benefit received principle is followed?		
11	Whether the cost of shared services assigned on		

	the basis of actual usage?		
12	Whether the resource by way of infrastructure shared? If yes, whether such costsare assigned on readiness to serve basis?		
Disclosure			
13	Whether cost statements disclosed the following in relation to administrative overhead: - Basis of assignment of administrative overheads to cost objects - Imputed Cost included as a part of administrative cost - Admin overhead incurred in foreign exchange - Cost of admin activities received from or supplied to related parties - Subsidy/ grant/ Incentive or any similar nature received/ receivable reduced from admin overheads - Credits / recoveries relating to admin overheads - Penalties and damages excluded		
14	Whether the disclosures made are significant, material and quantifiable?		
15	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
16	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on admin overheads disclosed?		

CAS – 12 Repair and Maintenances

S No.	Particulars	Documentation/ Working Paper	Remarks
Repair and Maintenance			
	• Check the basis of allocation of repair & maintenance cost to the cost centre. • Check whether any major repairs, which has		

	enhanced the life of the assets, has been capitalised with the related assets? • Check whether repair and maintenance arebooked separately for Building, Machinery and other and treated accordingly in the cost records?		
Principles of Measurement			
1	Whether proper records showing the expenditure incurred by the workshop, tool room and on repairs and maintenance are maintained cost center wise/ department wise?		
2	Whether expense on repair and maintenance activity identified as direct and indirect cost respectively? Whether there is adequate basis of identifying direct expense to the respective cost center? Whether there is adequate basis for allocating indirect expense to the cost centers?		
3	Whether there are separate methods of computing the cost of repair & maintenance of: a) R & M done in house b) R & M done by contractor inside the factory c) R & M done by outside the factory Whether any free supply of materials to contractor is booked in R & M cost also?		
4	Whether each type of repairs and maintenance treated as distinct activity? Whether such distinct activity is material and identifiable?		
5	Whether cost of repairs and maintenance activity measured for each major asset category separately?		
6	Whether the cost of spares replaced which enhance the future economic benefits of existing asset beyond its previously assessed standard of performance are not included under repairs and maintenance cost? Whether such spares are capitalised on the		

	concerned asset as per its useful life?		
7	Whether there a method for valuation of high value spares which are used after reconditioning? Whether such reconditioning spares are taken into stock? Whether the difference between value of reconditioning spares and value of new spares are taken as repair and maintenance cost?		
8	On what basis the cost of major overhaul amortised?		
9	Whether finance costs incurred in connection with the repairs and maintenance activities included in repairs and maintenance costs?		
10	Whether repairs and maintenance costs include imputed costs?		
11	Whether standard costing system is followed? If yes, whether the normal variances in repairs are treated as part of such expenses? Whether variances due to abnormal reasons excluded from repair and maintenance cost?		
12	Whether any Subsidy or Grant or Incentive or amount of similar nature received/ receivables with respect to repairs and maintenance activity, reduced/credited to such cost?		
13	Whether any repairs and maintenance cost resulting from some abnormal circumstances, namely, major fire, explosion, flood and similar events excluded?		
14	Whether fines, penalties, damages and similar levies paid to statutory authorities or other third parties excluded from repairs and maintenance cost?		
15	Whether Credits or recoveries relating to the repairs and maintenance activity, material and quantifiable, are deducted to arrive at the net repairs and maintenance cost?		
16	Whether any changes in cost accounting principle applied for measurement of the repair and		

	maintenances Cost? Whether such change complies with the requirement of law or cost accounting standards? Whether such changes results in appropriate preparation or presentation of cost statements?		
17	Whether there is any method for tracing of the repair and maintenance cost directly to the cost centre / cost objects?		
Assignment of Costs			
18	Whether there is any basis of allocation of common repair and maintenance cost to the cost object?		
19	Whether Cause and Effect or Benefits Received principle followed while assigning the cost incurred indirectly?		
20	Whether R & M cost (including the share of the cost of reciprocal exchange of service) is shared by several cost objects? Whether the related cost are measured as an aggregate and distributed among the cost object as per the laid down principles?		
Disclosures			
21	Whether cost statements disclosed the following in relation to repair and maintenance cost: - Basis of distribution of R & M cost to cost object/ cost units - Standard cost of Repair and Maintenance, and the price and usage variance - R & M cost of job done in house and outsourced separately - Cost of major overhaul, assets category wise, basis of amortisation - R & M cost paid / payable to related parties - R & M cost incurred in foreign exchange - Subsidy / Grant / Incentives or any amount of similar nature received / receivable reduced from R & M cost - Credit / recoveries relating to R & M cost - Abnormal portion of R & M cost		

	- Penalties and damages excluded from R & M cost.		
22	Whether the disclosure made are significant, material and quantifiable?		
23	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
24	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on R & M cost disclosed?		

CAS -13 Service Cost Centre

S No	Particulars	Documentation/ Working Paper	Remarks
Principle of Measurement			
1	• Whether proper records maintained in respect of service departments, i.e. service cost centres? • Whether such cost centres are primarily providing auxiliary services across the enterprise? • Whether each cost centre are treated as distinct cost centre? If no, please provide the brief write up and method of treatment of such cost centre? • Whether such cost centre capture expenses incurred in respect of each such service cost centre like engineering, work shop, designing, laboratory, safety, transport, computer cell, welfare and other related centres? • Whether such cost is aggregate of direct and indirect cost attributable to services rendered by the cost centre?		
2	Whether cost of in-house services includes cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such service?		

	Whether cost of other resources includes related overheads?		
3	Whether the cost of services rendered by contractors within the facilities of the entity includes: - charges payable to the contractor - cost of materials, - consumable stores, - spares, - manpower, - equipment usage, - utilities, and - other resources provided to the contractors for such services?		
4	Whether cost of service rendered by contractor at their premises is determined at invoice or agreed price including duties and taxes and other expenditure directly attributable thereto net of discounts (other than cash discount) Whether taxes and duties refundable are credited to such cost? Whether such cost includes the cost of resources provided to the contractor?		
5	Whether cost of services for the purpose of inter unit transfers include distribution costs incurred for such transfers?		
6	Whether cost of services for the purpose of inter-company transfers include distribution cost incurred for such transfers and administrative overheads?		
7	Whether the cost of services rendered to outside parties include distribution cost incurred for such transfers, administrative overheads and marketing overheads?		
8	Whether the finance costs incurred in connection with the service cost Centre excluded from the cost of Service Cost Centre?		
9	Whether the Cost of service cost centre excludes imputed costs?		

10	Whether the cost of service cost centre is accounted at standard cost? If yes, whether price and usage variance related to such cost is treated as part of such cost? Whether usage variance due to abnormal reasons is treated as part of abnormal cost?		
11	Whether any Subsidy or grant or incentive or any such payment (if received) with respect to any service cost centre is credited to such cost?		
12	Whether cost of production and distribution of the service is determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, treated as abnormal cost? Whether cost of a stand-by service includes the committed costs of maintaining such a facility for the service?		
13	Whether any abnormal cost where material and quantifiable forms part of the cost of the service cost centre?		
14	Whether the penalties, damages paid to statutory authorities or other third parties forms part of the cost of the service cost centre?		
15	Whether the credits or recoveries relating to the service cost centre including charges for services rendered to outside parties reduced from the total cost of that service cost centre?		
Assignment of Cost			
16	Whether there is any change in cost accounting principle applied for measurement of cost of service costcenter? Whether it is required by law or for compliance with the CAS? Whether such change would result in a more appropriate preparation or presentation of cost statements?		
17	• Whether the cost of services rendered by a service cost centre is directly traceable to cost object?		

	• Whether the appropriate basis adopted for assignment of cost of services rendered by a service cost centre where it is not directly traceable to cost object? • Whether the most appropriate basis of distribution of cost of a service cost centre to the cost centres consuming services is derived from logical parameters related to the usage of the service rendered? • Whether such parameter is equitable, reasonable and consistent?		
Disclosure			
18	Whether the cost statements disclosed the following: - Basis of distribution of cost of each service cost centre to consuming centre - Cost of purchase, production, distribution, marketing and price of service with reference to sales to outside parties? - Standard Cost, and the price and usage variance - Subsidy/ Grant / Incentives and such payment reduced from Service Cost Centre - Cost of service received from / rendered to related parties - Credit / recoveries relating to service cost centre - Any abnormal cost excluded from cost of service cost centre - Penalties and damages paid excluded from cost of service cost centre		
19	Whether the disclosures made are significant, material and quantifiable?		
20	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
21	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on service center cost disclosed?		

CAS-14 Pollution Control Cost

S No	Particulars	Documentation/ Working Paper	Remarks
Principles of Measurement			
1	Whether adequate records maintained to indicate the expenses incurred in respect of pollution control?		
2	Whether Pollution control costs are aggregate of direct and indirect cost relating to pollution control activity?		
3	Whether Direct Pollution cost include the cost of materials, consumable stores, spares, manpower, equipment usage, utilities, resources for testing and certification and other identifiable resources consumed in activities such as waste processing, disposal, remediation and others?		
4	Whether Indirect cost include the cost of resources common to various pollution control activities such as pollution control registration and such like expenses?		
5	Whether costs of pollution control, which are internal to the entity,are accounted for when incurred and measured at the historical cost of resources consumed?		
6	Whether future remediation or disposal costs which are expected to be incurred with reasonable certainly as part of onerous contract or constructive obligation, legally enforceable is estimated and accounted far based on the quantum of pollution generated in each period and the associated cost of remediation or disposal in future?		
7	Whether any contingent future remediation or disposal costs e.g. those likely to arise on account of future legislative changes on pollution control are treated as cost?		
8	Whether external costs of pollution which are		

	generally the costs imposed on external parties including social cost that are difficult to estimate with reasonable accuracy excluded from general purpose cost statements?		
9	Whether social cost of pollution measured by economic models of cost measurement? Whether cost by way of compensation by the polluting entity either under future legislation or under social pressure that cannot be quantified by traditional models of cost measurement kept out of general purpose cost statements?		
10	Whether cost of in house pollution control activity includes cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity?		
11	Whether cost of pollution control actively carried out by outside contractors inside the entity includes charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs?		
12	Whether cost of pollution control jobs carried out by the contractor at its premises is determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. Whether such cost also includes the cost of other resources provided to the contractors?		
13	Whether cost of pollution control jobs carried out by outside contractors includes charges made by the contractor and cost of own materials, consumable stores, spares, manpower, equipment usage, utilities and other costs used in such Jobs?		
14	Whether finance costs is excludedfrom the pollution control costs?		
15	Whether imputed costs are excluded from the pollution control costs?		

16	Whether standard costing is applied in computing Pollution control expenses? Whether price variance related to pollution control is treated as part of pollution cost in normal circumstances?		
17	Whether subsidy or grant or incentive or amount of similar nature (if received) with respect to Pollution control activity is credited to such cost?		
18	Whether any Pollution control cost resulting from abnormal circumstances excluded from pollution control cost?		
19	Whether any fines, penalties, damages and similar levies paid to statutory authorities or other third parties form are excluded from pollution control cost?		
20	Whether credits or recoveries relating to the pollution control activity are deducted to arrive at the net pollution control cost?		
21	Whether research and development cost incurred to develop new process, new products or use of new materials to avoid or mitigate pollution is treated as research and development costs and not included under pollution control costs? Whether development costs incurred for commercial development of such product, process or material included in pollution control costs?		
22	Whether there is any change in the cost accounting principles applied for the measurement of the pollution control cost in the current audit period?		
Assignment of Cost			
23	Whether Pollution Control costs is traced to a cost object to the extent economically feasible? Whether Direct costs of pollution control such as treatment and disposal of waste assigned directly to the product, where traceable economically?		
24	Whether pollution control costs are not directly traceable to the product but traceable to a process		

	which causes pollution are assigned to the products passing through the process based on the quantity of the pollutant generated by the product?		
25	Whether the pollution control cost not directly traceable to cost object are treated as overhead and assigned based on either of the following two principles; namely: (1) Cause and Effect (2) Benefits received		
26	Whether the Pollution Control cost (including the share of cost of reciprocal exchange of services) is shared by several cost objects? Whether such related cost is measured as an aggregate and distributed among the cost objects as per the laid down principles?		
Disclosure			
27	Whether the cost statements disclosed the following: - Basis of distribution of Pollution control cost to the cost object / cost units - Standard Cost, and the price and usage variance - Job done in-house and outsourced separately - Cost Paid / Payable to related parties - Cost incurred in foreign exchange - Subsidy / Grant / Incentives or any amount of similar nature received / receivable - Credit / recoveries relating to such cost - Abnormal portion of such cost - Penalties and damages excluded from such cost		
28	Whether the disclosures made are significant, material and quantifiable?		
29	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		

30	Whether any cost incurred on pollution control relating to prior periods and directly taken to reconciliation disclosed separately.		
31	Where estimates are made of future costs to be incurred on pollution control, whether the basis of estimate disclosed separately?		
32	Whether a descriptive note dealing with the social cost of pollution caused by the entity and the control of such pollution is prepared? Whether the cost statement carries a reference to such descriptive note?		
33	Whether any change made in the cost accounting principles and methods applied for the measurement and assignment of the Pollution Control cost during the period covered by the cost statement which has a material effect on the pollution control disclosed?		

CAS-15 Selling and Distribution Cost

S No	Particulars	Documentation/ Working Paper	Remarks
Principles of Measurement			
1	Whether adequate records maintained to indicate the expenses incurred in respect of selling and distribution cost? Whether post sales costs such as warranty cost, product liability cost, after sales service estimated on a reasonable basis?		
2	Whether the benefits of which are expected to selling and distribution costs is aggregate of cost of resources consumed in selling & distribution activities?		
3	Whether such cost of resources procured form outside is determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), and taxes & duties refundable or to be credited by the tax		

	authorities?		
4	Whether selling and distribution cost excludes the imputed cost?		
5	Whether cost of after sales service provided in terms of sale agreement for a class of transactions determined on rational and scientific basis? Whether such basis is net for recovery on the service?		
6	Whether subsidy or grant or incentive or amount of similar nature (if received) with respect to selling and distribution is credited to such cost?		
7	Whether any abnormal cost relating to selling and distribution activity excluded from selling and distribution cost?		
8	Whether any demurrage or detention charges or penalty paid by transportation or other authorities in respect of distribution activity is excluded from selling and distribution cost?		
9	Whether penalties and damages paid to statutory authorities or third parties is part of selling and distribution?		
10	Whether credit / recoveries relating to the selling and distribution overheads including those rendered without consideration, material and quantifiable is deducted to arrive at the selling and distribution overheads?		
11	Whether there is any change in the cost accounting principles applied for the measurement of the selling and distribution cost in the current audit period? Whether such change is required by law or regulation or for compliance with CAS? Whether such change would result in more appropriate preparation or presentation of cost statements?		
Assignment of Cost			
12	Whether selling and distribution costs is traced to a cost object to the extent economically feasible?		

	Whether such cost is assigned directly to the relevant product sold or service rendered?		
13	Whether transportation cost relating to distribution is assigned as per CAS-5, where relevant and applicable?		
14	Whether such cost is assigned based on either the following principles; a) Cause and Effect b) Benefits received		
Disclosure			
15	Whether the cost statements disclosed the following : - Basis of distribution of selling and distribution cost to the cost object / cost units - Selling and distribution overhead incurred in foreign exchange - Standard Cost, and the price and usage variance - Cost Paid / Payable to related parties - Subsidy / Grant / Incentives or any amount of similar nature received / receivable reduced - Credit / recoveries relating to such cost - Abnormal portion of such cost - Penalties and damages excluded from such cost		
16	Whether the disclosures made are significant, material and quantifiable?		
17	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
18	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on the selling and distribution cost disclosed?		

CAS-16 Depreciation and Amortisation

S	Particulars	Documentation/	Remarks

No		Working Paper	
General Purpose Checklist			
	• Check whether, proper records of all assets with location, depreciation and balance amount with useful life is maintained i.e. Fixed Assets Register? • Check whether the rate of depreciation followed is as per schedule II of companies act, 2013? In case of any deviation, whether the justification for the same is obtained? • Whether adequate basis are provided for cost-centre wise allocation of depreciation? • Whether any revaluation of assets is done? If yes, whether its effect is nullified in costing profit and loss account? • Whether any adequate policy is maintained for accounting of small assets? • Whether any impairment loss is accounted for? If yes, whether its effect is nullified in costing profit and loss account? • Whether system for tracking running hours of assets, connected load and output achieved, and shut down days maintained?		
Principles of Measurement			
1	Whether adequate records maintained to indicate the proper classification and amount of Fixed Assets i.e. Fixed Asset Register?		
2	Whether depreciation and amortisation is measured based on the depreciable amount and the useful life?		
3	Whether the residual value of intangible asset is assumed to be Zero unless (a) there is commitment by a third party to purchase the assets or (b) there is active market for the assets and (i) Residual value can be determined by reference to that market; and (ii) It is probable that such market will exist at the end of the useful life.		

	Whether residual value of fixed assets is considered as zero if the entity is unable to estimate the same with reasonable accuracy?		
4	Whether minimum amount of depreciation to be provided is not less than the amount calculated as per principles and methods as prescribed by any law or regulations applicable to the entity and followed it?		
5	Whether in case of regulated industry the amount of depreciation is the same as prescribed by the concerned regulator?		
6	Whether while estimating the useful life of a depreciable assets, consideration is given to the following factors; (a) Expected physical wear and tear; (b) Obsolescence; and (c) Legal or other limits on the use of the asset.		
7	• Whether useful life of an intangible assets that arises from contractual or other legal rights, is equal to the period of such contractual or other legal rights? • Whether useful life of an intangible assets that arises from contractual or other legal rights, is shorter than the period of such contractual or other legal rights? If yes, how the useful life period has been determined? • Whether the contractual or other legal right can be renewed? If yes, whether the useful life of the intangible asset is based on the renewal period(s) only if there is evidence to support that the renewal shall be without significant cost? • Whether useful life of a re-acquired right recognised as an intangible asset in a business combination is based on the remaining contractual period of the contract in which the right was granted excluding the renewal periods? • Whether the useful life of an intangible asset exceeds 10 years from the date it is available		

	for use? If yes, state the reasons.		
8	Whether depreciation is considered from the time when a depreciable asset is available for use?		
9	Whether depreciation ofassets temporary retired from production of goods or services is considered as abnormal cost for the period when asset is not in use?		
10	Whether depreciation of any addition or extension to an existing depreciable asset which become integral part of that asset is based on the remaining useful life?		
11	Whether depreciation of any addition or extension to an existing depreciable asset which retains a separate identity and is capable of being used after the expiry of the useful life of that asset is based on the estimated useful life of that addition or extension?		
12	Whether the impact of higher depreciation due to revaluation of assets is excluded from the cost?		
13	Whether impairment loss on assets is excluded from cost of production?		
14	Whether method of depreciation used reflects the pattern on which the asset's future economic benefits are expected to be consumed by the entity?		
15	Which of the following method is used for depreciation? a) Straight line method b) Diminishing balance method c) Units of Production method Whether method used is deviated from the method defined under Companies Act, 2013? If yes, state reasons of the same.		
16	Whether method of amortisation of intangible asset reflects the pattern in which economic benefits accrue to entity?		
17	Whether methods and rates of depreciation applied reviewed annually?		

	Whether method applied has been changed if there has been achange in expected pattern of consumption or loss of future economic benefits?		
18	Whether spares purchased specifically for an asset or class of assets became redundant when such asset or class of assets was retried or use of that asset was discontinued? Whether depreciable amount of such spares is allocated over the useful life of the asset?		
19	Whether cost of small assets is written off in the period in which they were purchased? Whether such purchase are written off as per the accounting policy of entity?		
20	Whether depreciation is not considered in case where the cumulative depreciation exceeds the original cost of assets?		
21	Whether depreciation of additional asset is measured and assigned to the cost object on the basis of the number of days for which asset is used?		
Assignment of Cost			
22	Whether depreciation is traced to a cost object to the extent economically feasible?		
23	Whether the depreciation that is not directly traceable to cost object, is assigned either on the following two principles; namely: (1) Cause and Effect (2) Benefits received		
Disclosure			
24	Whether the cost statements disclosed the following : - Basis of distribution of depreciation and amortization cost to the cost object / cost units - Credit / recoveries relating to such cost - Abnormal portion of such cost - Amount of depreciation not included in cost because of temporary retirement of assets		

25	Whether the disclosures made are significant, material and quantifiable?		
26	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
27	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on the depreciation and amortization cost disclosed?		

CAS-17 Interest and Financing Charges

S No	Particulars	Documentation/ Working Paper	Remarks
Principle of Measurement			
1	Whether Interest and financing charges incurred by an enterprise in connection with the borrowing of funds represent payment in the nature of interest for the use of non-equity funds?		
2	Whether Interest and financing charges incurred are directly attributable for- (I) acquisition or construction or production of qualifying assets including fixed assets; and (II) other finance costs for production of goods or operations or services rendered which cannot be classified as qualifying assets.		
3	Whether the interest and financing charges which are directly attributable to the acquisition or construction or production of a qualifying asset is included in the cost of the asset?		
4	Whether imputed costs excluded from the interest and financing charges?		
5	Whether any subsidy or grant or incentive or amount of similar nature (if received) with respect to interest and financing charges, is credited to such cost?		

6	Whether penal interest for delayed payment, fines, penalties, damages and similar levies paid to statutory authorities or other third parties is excluded from interest and financing charges?		
7	Whether interest paid for or received on investment is excluded other financing charges for production of goods or operations or services rendered?		
Assignment of costs			
8	What is the basis of assignment of interest and financing charges to the cost object?		
9	Whether assignment of Interest and Financing Charges to the cost objects is basedon either of the following principles; I. Cause and effect II. Benefits received		
Disclosure			
10	Whether the cost statement disclosed the following: - Basis of distribution of interest and financing charges - Rate and usages, where predetermined cost is applied - Paid / payable to related parties - Interest and finance charges incurred in foreign exchange - Subsidy/ Grant / Incentives or any similar nature received / receivable reduced from Interest and Financing charges		
11	Whether the disclosures made are significant, material and quantifiable?		
12	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		

13	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on the interest and financing cost disclosed?		
14	Whether interest and financing charges incurred relating to prior periods and directly taken to reconciliation disclosed?		

CAS 18 Research and Development Cost

S No	Particulars	Documentation/ Working Paper	Remarks
Principle of Measurement			
1	Whether research and development costs include all the costs that are directly traceable to research or development activities.		
2	Whether research and development costs include the following elements, namely:- (a) the cost of materials and services consumed in research and development activities; (b) cost of bought out materials and hired services as per invoice or agreed price including duties and taxes directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited; (c) salaries, wages and other related costs of personnel engaged in research and development activities; (d) depreciation of equipment and facilities, and other tangible assets and amortisation of intangible assets to the extent that they are used for research and development activities; (e) overhead costs, other than general administrative costs, relating to research and development activities; (f) costs incurred for carrying out research and development activities by other entities and charged to the entity; (g) expenditure incurred in securing copyrights		

	or licences; (h) expenditure incurred for developing computer software; (i) costs incurred for the design of toots, Jigs, moulds and dies; and (j) other costs that can be directly attributed to research and development activities and can be identified with specific projects.		
3	Whether the method adopted for the computation of R&D cost followed consistently?		
4	Whether subsidy or grant or incentive or amount of similar nature (if received) with respect to research and development activity is credited to the cost of such activity?		
5	Whether any abnormal cost, if material and quantifiable, is excluded the from R & D cost?		
6	Whether fines, penalties, damages and similar levies paid to statutory authorities or other third parties are excluded from research and development cost?		
7	Whether amortization of an intangible asset arising from development activity treated as "Depreciation and Amortization"as set out CAS-16?		
8	Whether research and development costs exclude imputed costs?		
9	Whether credits or recoveries relating to research and development cost, if material and quantifiable, deducted while computing research and development cost?		
10	Whether sale of output produced from the R & D activity is deducted while computing research and development cost?		
Assignment of Costs			
11	Whether R & D costs attributable to a specific cost object assigned to the cost object directly? Whether R & D cost that is not attributable to a specific product or process is excluded from product cost?		

12	Whether development cost that results in the creation of intangible asset is amortized over its useful life?		
13	Whether assignment of development cost is based on principle of benefits received?		
14	Whether proper method applied for identifying the expenses pertaining to research & development activity for: • Existing products • Process or product improvement for existing products resulting in benefits for more than one accounting period • Products under development or future products		
15	Whether development cost attributable to a saleable service i.e. providing technical knowhow to outside parties is treated as cost of providing the service?		
Disclosures			
16	Whether the cost statements disclosed the following : - Basis of accumulation and assignment of R & D - R & D cost paid to third parties - Credit / recoveries from related parties - R & D incurred in foreign exchange - Subsidy/ Grant / Incentives and such payment reduced from R & D costs - Credit / Recoveries deducted from R & D cost - Abnormal cost excluded from R & D costs including cost of abandoned projects & research activities considered abnormal - Penalties and damages paid etc. excluded from R & D cost		
17	Whether the disclosures made are significant, material and quantifiable?		

18	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
19	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on the interest and financing cost disclosed?		

CAS 19 Joint Cost

S No.	Particulars	Documentation/ Working Paper	Remarks
Principles of Measurement			
1	Whether proper records are maintained for each item of joint product or by-product, if any, showing the receipt, issues, and balances, both in quantity and value?		
2	Whether the principle and methods for measuring joint cost up to split off point is same as stipulated in other cost accounting standards?		
3	Whether the basis adopted for valuation of by-product for giving credit to the respective process is equitable and consistent? Whether records showing the expenses incurred on further processing and actual sales realisation of by-product maintained? Whether proper records have been maintained in respect of credits or recoveries from the disposal of by-products?		
4	Whether reasonable and equitable basis is applied consistently for apportionment of joint costs upto the point of separation of joint products or services? Whether such basis are indicated in the cost records? Whether proper records maintained in respect credits or recoveries from the disposal of joint products or services?		

5	Whether cost incurred after split off point on product separately identifiable measured for the resources consumed for each Joint/ by product?		
6	Whether cost incurred after split off point for further processing of joint product / by product is aggregate of direct and indirect cost?		
7	Whether cost of further processing of joint product / by product carried out by outside parties is determined at invoice or agreed price including duties and taxes, net of discounts (other than cash discount) taxes and duties refundable is to be credited and other expenditure directly attributable to such processing? Whether such cost also includes the cost of resources provided to the outside parties?		
8	Whether the realized or realizable value, net of disposal cost, of scrap and waste is deducted from the cost of Joint product?		
9	Whether any subsidies / Grant / Incentives or any such payments received / receivable with respect to joint product / By Product reduced for ascertainment of the cost?		
10	Whether penalties, damages paid to statutory authorities or third parties excluded from the cost of joint product / By product?		
Assignment of Cost			
11	Whether Joint cost incurred to joint products is assigned based on benefits received? Whether these are measured by using any of following method? a. Physical Units Method. b. Net Realisable Value at spilt off point. c. Technical estimates Whether NRV is calculated by using formula Net Selling price per unit * QTY Whether NRV is adjusted for the post split off costs?		
12	Whether the value of By-Product is estimated by using any of the following matters for adjusting		

	joint cost? a. Net realizable value b. Technical estimates		
Disclosure			
13	Whether cost statements disclosed the basis of allocation of Joint costs to individual products and the value assigned to the by-products?		
15	Whether the disclosures made are significant, material and quantifiable?		
16	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
17	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on the measurement and assignment of Joint cost and the value assigned to by-product disclosed?		

CAS 20 Royalty and Technical Know How

S No.	Particulars	Documentation/ Working Paper	Remarks
Principles of Measurement			
1	Whether adequate records maintained showing royalty or technical know-how fee including other recurring or non-recurring payments of similar nature, if any, made for the goods or services?		
2	Whether there is any amortization of Royalty and technical knowhow fee? If yes, whether consistent basis for such amortization followed?		
3	Whether royalty and technical knowhow fee excludes finance and imputed costs?		
4	Whether subsidy or grant or incentives or any such payments (if received) with respect to amount of royalty and technical know how fee is credited or net off to from Technical Know How		

	cost?		
5	Whether penalties, damages paid to statutory authorities or other third parties are excluded from amount of royalty and technical know-how fee?		
6	Whether credits or recoveries relating to the amount of royalty and technical know-how fee, deducted to arrive at the net amount of royalty and technical know-how fee?		
7	Whether there is any change in the cost accounting principles applied for the measurement of the amount of royalty and technical knowhow fee for the current audit period? Whether such change complies with the requirement of law or cost accounting standards? Whether such changes results in appropriate preparation or presentation of cost statements?		
Assignment of Cost			
8	Whether royalty and technical know how fee is directly traceable to cost object? Whether such fees are assigned on following basis if it is not directly traceable to cost object: a. Units Produced b. Units Sold c. Sales Value		
9	Whether any royalty paid for mining rights? If yes, whether such fee is assigned on the nature / purpose of such fee?		
Disclosure			
10	Whether cost statements disclosed the following in relation to royalty or technical know-how fee: • Basis of distribution of amount of Royalty and Technical Know-how fee to cost objects • Quantity and the related rate of item of the amount of Royalty and Technical knowhow fee, as applicable • Royalty and know-how fee paid / payable to		

	related parties • Royalty and know-how incurred in foreign exchange • Subsidy/ grant/ Incentive or any similar nature received/ receivable reduced from Royalty and Technical Know-how fee • Credits / recoveries relating to amount of Royalty and Technical Know-how • Penalties and damages excluded		
11	Whether the disclosures made are significant, material and quantifiable?		
12	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		

CAS 21 Quality Control Costs

S No.	Particulars	Documentation/ Working Paper	Remarks
Principle of Measurements			
1	Whether adequate records maintained to indicate the expenses incurred in respect of quality control department or cost centre or service centre for goods or services under reference?		
2	Whether quality control cost incurred in-house is the aggregate of the cost of resources consumed in the quality control activities of the entity? Whether such cost includes cost of conformance to quality, namely, (a) prevention cost; and (b) appraisal cost?		
3	Whether the cost of resources procured from outside is determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), taxes and duties refundable or to be credited by the Tax		

	Authorities?		
4	Whether identification of quality control costs is based on traceability in an economically feasible manner?		
5	Whether quality control costs other than those referred above are determined on the basis of amount incurred in connection therewith?		
6	Whether finance costs incurred in connection with self generated or produced resources excluded from quality control cost?		
7	Whether imputed costs do not form part of quality control cost?		
8	Whether Subsidy or grant or incentive or any such payment (if received) with respect to any quality control cost are credited to such cost?		
9	Whether abnormal portion of the quality control cost excluded from the cost of quality control?		
10	Whether penalties, damages paid to statutory authorities or other third parties excluded from quality control cost?		
11	Whether there is any change in the cost accountings principles applied for the measurement of the quality control cost during the Audit period? Whether such change complies with the requirement of law or cost accounting standards? Whether such change results in a more appropriate preparation or presentation of cost statements?		
Assignment of Cost			
12	Whether there a proper system of assignment of Quality control costs to the respective cost objects?		
13	Whether Quality control costs are directly traceable or assignable to the cost objects?		
14	Whether assignment of quality control cost to		

	the cost objects is based on benefits received by them?		
Disclosure			
15	Whether cost statements disclosed the following: • Basis of distribution of quality control cost to the cost objects / cost unit • Quantity and cost of resources used for quality control cost • Quality control cost paid / payable to related parties • Quality control cost incurred in foreign exchange • Abnormal portion of the quality control cost • Penalties and damages excluded from the quality control cost		
16	Whether the disclosures made are significant, material and quantifiable?		
17	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
18	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on the measurement and assignment of quality control costs disclosed?		

CAS 22 Manufacturing Cost

S No.	Particulars	Documentation/ Working Paper	Remarks
Principle of Measurement			
1	Whether proper records of production and sale of all excisable products maintained separately?		
2	Whether Manufacturing cost of each excisable		

	product is aggregate of direct and indirect cost relating to manufacturing activity?		
3	Whether material cost is measured separately for each type of excisable productsand for the following categories a) Indigenous Material b) Imported Material c) Bought Out Component d) Process Material e) Self Manufactured items f) Accessories Whether cost of inputs received free of cost or at concessional value from buyer of the excisable goods considered for determination of manufacturing cost?		
4	• Whether material cost of normal scrap/ defectives which are rejects included in material cost of excisable goods manufactured? • Whether material cost of actual scrap / defectives not exceeding normal quantity adjusted in the material cost of good production? • Whether realized or realizable value of scrap or waste deducted for determination of manufacturing cost? • Whether material cost of abnormal scrap / defectives excluded from the material cost and treated as loss after realisable value of such scrap/ defectives?		
5	Whether employee cost for each excisable product measured separately?		
6	Whether the cost of utilities consumed for manufacturing of excisable products measured for each type of utility?		
7	Whether packing material cost used for each type of excisable products measured separately?		
8	Whether direct expenses for manufacturing of excisable products measured for each excisable		

	product separately?		
9	Whether repairs and maintenance cost for manufacturing of excisable products measured for each excisable product separately?		
10	Whether depreciation and amortization cost for manufacturing of excisable products measured for each excisable product separately?		
11	Whether R & D cost for manufacturing of excisable products measured for each excisable product separately?		
12	Whether cost incurred for manufacturing of excisable products after spilt off point is measured for each Joint / by product? Whether cost of scarp or waste generated in the manufacturing process deducted from the cost of joint product?		
13	Whether royalty and Know How fee for manufacturing of excisable products paid or incurred on Lump sump basis? Whether such costs made as 'one time' payment is amortised on the basis of the estimated output or benefit derived from the related Technical Know How? Whether royalty paid on sales excluded from manufacturing cost of excisable goods?		
14	Whether quality control cost incurred in house for manufacturing of excisable products is aggregate of the cost of resources used in Quality control activities? Whether cost of resourced procured outside is determined at invoice or agreed price including duties and taxes and other expenditure directly attributable thereto net of discounts?		
15	Whether manufacturing overheads for excisable products representing procurement of resources is determined at invoice or agreed price?		
16	Whether any abnormal cost, which is material and quantifiable, is not part of manufacturing cost of excisable goods?		

17	Whether Interest and other finance cost is excluded from part of manufacturing cost of excisable goods?		
18	Whether manufacturing cost of excisable good include cost of inputs received free of cost or at concessional value from the buyer of excisable good and amortisation cost of free tools, pattern, dies, drawings, blue prints, technical maps, charts, engineering, development, art work, design work, plans, sketches, and the like necessary for production of excisable good?		
19	Whether manufacturing cost of excisable good also include cost of rework, reconditioning, retro-fitment, manufacturing overheads and other costs allocable to such activity, adjustment for stock of work-in-process and recoveries from sales of scrap and wastages and the like necessary for production of excisable good?		
20	Whether Subsidy/Grant/Incentive or any such payment received/receivable, fromother entity other than the buyer, with respect to any manufacturing cost of excisable good is deducted for ascertainment of the manufacturing costof excisable good to which such amounts are related?		
21	Whether manufacturing cost of excisable good is determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, treated as abnormal cost?		
22	Whether Fines, penalties, damages, demurrage and similar levies paid to statutory authorities or other third parties excluded from the manufacturing cost of excisable good?		
23	Whether forex component of imported material or other element of cost is converted at the rate on the date of the transaction? Whether any subsequent change in the exchange rate till payment or otherwise excluded from the manufacturing cost of excisable good?		

24	Whether Credits/recoveries relating to the manufacturing cost, which are material and quantifiable, deducted from the total manufacturing cost to arrive at the net manufacturing cost of excisable good.		
25	Whether stock of work-in-process/progress is valued at cost on the basis of stages of completion as per cost accounting principles? Whether Opening and closing stock of work-in process/ progress is adjusted for computation of manufacturing cost of anexcisable good?		
Assignment of Cost			
26	Whether manufacturing cost of excisable goods is directly traceable or assignable to the cost objects?		
27	Whether such cost of excisable goods is assigned on the basis of following principle a) Cause and effect b) Benefit received		
28	Whether the variable manufacturing / production overhead is absorbed in proportion to benefit received by them?		
29	Whether fixed manufacturing overheads and other similar item of fixed cost relating to manufacturing is absorbed in manufacturing cost on the basis of normal capacity or actual capacity utilization, whichever is higher?		
30	Whether more than one product are produced from same production process? Whether any by product or joint product generated with such process? Whether the net value realised from sale of by – product(if any) are credited to joint cost?		
31	Whether any miscellaneous income are generated from such process? Whether such misc. income is adjusted while determining the manufacturing cost?		
Disclosure			

32	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on the measurement and assignment of manufacturing cost of excisable goods disclosed?		
33	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
34	Whether the disclosures made are significant, material and quantifiable?		

CAS-23 Overburden Removal Cost

S No.	Particulars	Documentation/ Working Paper	Remarks
Principle of Measurement			
1	Whether Overburden Removal Cost is the aggregate of direct and indirect cost relating to overburden removal activity?		
2	Whether Direct cost includes the cost of consumable stores, spares like machinery spares, explosives and detonators, manpower, equipment usage, utilities, payment made directly to contractors and other identifiable resources consumed in such activity?		
3	Whether Indirect cost includes the cost of resources common to various mining operations including overburden removal activity such as manpower, administrative overheads, loading and unloading, equipment usage and other costs allocable to such activities?		
4	Whether the overburden removal cost attributable to a development phase of a mine area capitalised as non-current asset when it is probable that future economic benefits to the area will flow to the entity and such cost can beidentified and measured separately?		

5	Whether overburden removal cost attributable to developed area of mine is charged to production of ore at the Standard stripping ratio?		
6	Whether the cost of advance stripping activity whose economic benefit is likely to flow to the entity during the subsequent period, is capitalised and amortised.		
7	Whether removal of ore is more than standard striping ratio? If yes, whether the cost of short removal of overburden is charged to the cost of production either by creating the reserve or by adjusting the earlier capitalized overburden removal cost?		
8	Whether Overburden is measured by multiplying the number of trips undertaken by equipment for Overburden removal or by any electronic mode? Whether such measurement is carried out at regular intervals by volume/ physical verification to arrive at fair quantity of overburden removed? Whether Final assessment is made based on scientific methodology?		
9	Whether current ratio is determined by dividing the actual overburden removed (net quantity after due adjustment for opening & closing advance stripping quantity) with the actual production of mineral including adjustment for mineable quantity of mineral lying exposed during the period?		
10	Whether cost of overburden removal activity carried out by outsourcing is determined at agreed price as per contract price including duties and taxes and other expenditure directly attributable thereto? Whether the cost also include the cost of resources provided to the contractor by the company?		
11	Whether cost of overburden removal activity of		

	each mine is computed and considered separately?		
12	Whether subsidy / grant / incentive or amount of similar nature received/ receivable with respect to overburden removal activity if any is reduced for ascertainment of the cost of the overburden removal for a patch/ plot to which the amounts are related?		
13	Whether any overburden removal cost resulting from some abnormal circumstances, if material and quantifiable, excluded from overburden removal cost?		
14	Whether Fine, penalties, damages and similar levies paid to statutory authorities or other third parties excluded from the overburden removal cost?		
15	Whether Interest & Finance charges incurred in connection with the overburden removal excludes excluded from the overburden removal cost?		
16	Whether any change is made in the cost accounting principles applied for the determination of the overburden removal cost? Whether such change is made only if it is required by law or for compliance with the requirements of a cost accounting standard? Whether such change would result in a more appropriate preparation or presentation of cost statements of an enterprise?		
Assignment of Costs			
17	Whether Direct cost of overburden removal is assigned to the overburden removal activity?		
18	Whether the cost for equipment is assigned in the ratio of machine hours actually engaged for mineral and overburden removal? or Whether any other appropriate method is used to apportion the cost in an equitable manner?		

19	Which of the following method is used to apportion the Administrative overheads and other indirect expenses to mineral and overburden: (a) On the basis of ratio of actual mineral produced and overburden removed during the period, or (b) On the basis of actual machine hours engaged for mineral extraction, and overburden removal, or (c) Any other appropriate basis.		
Disclosure			
20	Whether the cost statements disclosed the following • Basis of determining the overburden removal cost • Any variation positive or negative from the current ration, where cost of removal is considered on the basis of standard ratio • Subsidy / grant / incentives or any such payments reduced form the cost of overburden • Credit / recoveries relating to overburden removal cost • Abnormal cost excluded from overburden cost • Penalties and damages excluded from overburden cost		
21	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on the measurement and assignment of overburden removal cost disclosed?		
22	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
23	Whether the disclosures made are		

	significant,material and quantifiable?		

CAS- 24 Treatment of Revenue in Cost Statements

S No.	Particulars	Documentation/ Working Paper	Remarks
1	Whether proper records maintained for treatment of revenue in books of accounts as well cost records?		
2	Whether revenue from sale of goods or services provided during a reporting period is measured based on net sales realization?		
3	Whether revenue from sale of joint product is measured separately for each main product or service?		
4	Whether revenue from sale of goods or services is measured separately for each unit or location of an entity for each type of goods sold or services provided? Whether it is sub-classified into revenue from exports, domestic sales, manufactured goods, operations and trading activities?		
5	Whether revenue from sale of goods or services is measured separately for sale of each type of by-products, defectives, second grade products, rejects, scrap, spoilage or wastage?		
6	Whether sales realisation of by-product is net of further processing cost? Whether its net sales realisation is adjusted against the joint cost of production of relevant main products?		
7	Whether net sales realisation of defectives, second hand grade products, rejects, scrap, spoilage and waste products is adjusted against cost of production of related goods sold?		
8	Whether revenue from sale of inputs, utilities, intermediates product, and shared or support services is adjusted against cost of purchase or cost of production of the related input, utility,		

	intermediate product and shared or support service?		
9	Whether other income is not considered in determining profit or loss as per cost accounts?		
10	Whether revenue generated from utilization of assets created under CSR programme excluded in determining profit or loss as per cost accounts?		
11	Whether product or services related subsidies, grants or incentives, received or receivable on sale of goods or rendering services is a part of revenue from operations? Whether same is identified with each product sold or services rendered?		
12	Whether any subsidy or grant, incentives or any such payment received or receivable to support the current operations of the entity other than those in the nature of capital grant and other items is treated as reduction in related cost?		
13	Whether any change is made in the cost accounting principles applied for determination of revenue? Whether such change is made only if it is required by law or regulations or for compliance with CAS? Whether such change results in more appropriate preparation and presentation of cost statement of entity?		
Assignment of Revenue			
14	Whether revenue of each type of product or service is assigned directly to that product or service to the extent it is economically feasible?		
Disclosure			
15	Whether the cost statements disclosed the following; • Revenue from sale of goods or services made to each related party with basis of determining the selling price • Revenue from by-product and costs of further processing after spilt–off point,		

	reduced from cost of relevant product • Amount and nature of any subsidy, grant or incentives received or receivable and included in the revenue		
16	Whether any significant changes made in the cost accounting policy and methods applied which has material effect on the measurement and assignment of revenue disclosed?		
17	How are the disclosure made? • In the body of cost statements • As footnote to the cost statements • As a separate schedule to the cost statements		
18	Whether the disclosures made are significant, material and quantifiable?		

Other Significant Areas

S No.	Particulars	Documentation/ Working Paper	Remarks
Other Costs			
1	Whether proper records have been maintained for any other item of cost being indispensable and considered necessary for inclusion in cost records for calculating cost of production of goods or rendering of services, cost of sales, margin in total and per unit of the goods or services under reference?		
Work in Progress and Finished Stock			
2	Whether the method adopted for determining the cost of work-in progress and finished goods is followed consistently?		
Adjustment of Cost Variance			
3	Whether the company maintains cost records on any basis other than actual such as standard costing? Whether the records indicate the procedure followed by the company in working out the cost of the goods or services under such system? Whether the cost variances is shown against		

	separate heads and analyzed into material, labour, overheads and further segregated into quantity, price and efficiency variances? Whether the method followed for adjusting the cost variances in determining the actual cost of the goods or services indicated clearly in the cost records? Whether the reasons for the variances duly explained in the cost records and statements?		
Reconciliation of Cost and Financial Accounts			
4	Whether cost statements are reconciled with the financial statements for the financial year specifically indicating the expenses or incomes not considered in the cost records or statements so as to ensure accuracy and to adjust the profit of the goods or services under reference with the overall profit of the company alongwiththe variations, if any? Whether all variations are clearly indicated and explained?		
Related Party Transactions			
5	Whether the Related party means related party as defined under clause (76) of section '2 of the Companies Act, 2013 (18 of 2013)?		
6	Which of the following method is adopted to determine normal price: (i) Comparable uncontrolled price method; (ii) Resale price method; (iii) Cost plus method; (iv) Profit split method; (v) Transactional net margin method; or (vi) Any other method, to be specified		
7	Whether record is maintained in respect of related party transactions or supplies made or services rendered by a company to a company termed "related party relationship" and vice-a-versa showing contracts entered into, agreements or understanding reached in respect of – (i) Purchase and sale of raw materials, finished		

	goods, rendering of services, process materials and rejected goods including scraps and other related materials; (ii) Utilisation of plant facilities and technical know-how; (iii) Supply of utilities and any other services; (iv) Administrative, technical, managerial or any other consultancy services; Purchase and sale of capital goods including plant and machinery; and (v) Any other payment related to the production of goods or rendering of services under reference.		
8	Whether records are maintained indicating the basis followed for arriving at the rates charged or paid for such goods or services?		

Appendix- VI

Illustrative Audit Procedure

(to be completed for all material cost heads, items of cost and disclosure)

Audit Program **Cost of Goods Sold**		*WP Ref:*	
		Prepared by:	
		Date:	
		Reviewed by:	
		Date:	
Client:			
Period:			
Subject:	Cost of Goods Sold		

Item Ledger / Account Balance :		***Amount in Rs.***
Cost Heads / Classes of Transactions :		

Sno.	Audit Procedures	Audit Assertion Addressed	Done By	W.P. Ref.
Test of Controls				
1.	Select a sample of transactions from each of the cost heads and check the following: *(only illustrative in nature, may be extensive in application of audit of cost statements)* - Transactions booked on actual and real time basis - Items of cost are supported by proper documentation.			

Sno.	Audit Procedures	Audit Assertion Addressed	Done By	W.P. Ref.
	- Treatment of indirect taxes done as per company, cost accounting policy - Rebates, discounts and other transactions are booked as per cost accounting principles - Basis of measurement are uniform throughout the period. - Posting are made in correct cost ledger / cost heads / cost records			
Analytical Procedures				
1.	Perform analytical review of cost of sales and inquire and collaborate significant variations from prior period and budgeted amounts.			
2.	Compare gross profit margins with comparable margins for the previous period with comparable margins for industry and with the budgeted margins for the current period and investigate unusual fluctuations.			
3.	Using benchmarks compare BOM cost, gross margins by product wise / product group wise, unit wise or period wise to those of the prior year and obtain explanation for unusual variances.			
4.	For other items in cost of goods sold: a) Review all item of cost analytically and document reasons for significant variance. b) Examine supporting documents for selected items to ensure their validity.			
Test of Details				
1.	Perform a predictive test of cost of goods sold by product wise, product group wise , unit wise by reference to details of units and its average cost. Investigate significant variances between the			

Sno.	Audit Procedures	Audit Assertion Addressed	Done By	W.P. Ref.
	predicted and recorded period.			
1.	Expand the test of details to voucher test of transactions related to cost of goods sold by tracing unit costs to rely on consumption recorded in cost records.			
2.	Determine cost information asserted in cost reporting framework are true and fair in all material and quantifiable respect.			
3.	Perform tests for basis of allocation of overhead cost to product. 1. for fixed overheads - In case of under utilization of normal capacity, the unabsorbed overheads should be charged as an abnormal loss. - In case of abnormally high production, the allocated overheads should not exceed the actual amount as this may result in over valuation of inventory. 2. for variable overheads - expand test of details to verify the allocation made on actual production basis and consistent. - Check the cost accounting policy for allocation of joint cost.			
4.	Perform test to verify transactions recorded relating to production overheads.			
5.	Perform test to verify cost estimate and provision made at the end of period.			
6.	Expand test of details to verify operating ration asserted, standard input – output norms and basis of absorption of normal and abnormal losses.			
7.	Perform test to verify the amount of depreciation recorded and any material difference in useful life of period, Further perform test of details to exclude			

Sno.	Audit Procedures	Audit Assertion Addressed	Done By	W.P. Ref.
	treatment of Revaluation and impairment losses.			
8.	Perform predictive test based on the agreed / average prices and received quantity.			
9.	Determine that all disclosures have been in accordance with the requirements of cost accounting standards and relevant requirements under companies act, 2013 or requirement under any other act.			
10.	Conclude the result of work			

Appendix- VII

Illustrative Identification and Assessment of key Risk of Material Misstatements

(to be completed for all material cost heads, items of cost and disclosure)

Area	
Cost Head Balances / General Ledger Balance	
Components of the Cost Head / items of Cost / Sub G/L balances	
Understanding of the process based on inquiry with: - Management Those charged with governance - Internal Auditor / Other Auditor(s) - Business Process Owners / Plant Manager/ Process Supervisor - Any other source	
Results of preliminary audit procedures – any unusual or unexpected changes occurred or interrelationship	
Results of verifications of internal controls - Control Environment / Control activities - Monitoring of controls - Risk Assessment - Information system and business process	
Results of observation and inspection of : - Entity’s operations - Documents, records and reports - Premises for forming opinion	
Other information available	

<table>
<tr><td>- Previous cost audits / experience
- Other engagements with similar industry / entity.
- Ongoing assessments
- Interim review / limited review for period.
- Discussion and supervision within team
- Any other source</td><td colspan="3"></td></tr>
<tr><td>Identified risks</td><td>Risk description</td><td>Inherent / Detection / Control</td><td>Assertion</td></tr>
<tr><td rowspan="3">Key risks</td><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td rowspan="3">Non- key risks</td><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td>Impact on any other area</td><td colspan="3"></td></tr>
</table>

Appendix – VIII

Qualitative Aspects of Cost Accounting Practices

The communication required 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:

- Management's identification of cost centres
- Management's process for treatment of items of cost
- Risks of material misstatement
- Indicators of possible management bias
- 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.

Appendix -IX

Illustrative Representation Letter

(This Illustrative Letter of representation may be modified as per the type/size of company, nature of audit, requirements under other SCAs, etc.)

The following letter is for use as a general guide with reference to the points mentioned in this respect. It may vary from one company to another and from one year to another. Therefore it can be adapted in view of individual requirements and circumstances.

(Company's letter head)

Date:

To,

M/S
Cost Accountants

Dear Sir/Madam

This representation letter is provided in connection with your audit of cost statements of (name of Company/ factory/ Unit)* for the (name the products/activities)* for the year ended__________ with the purpose of expressing an opinion as to whether the cost statements/ abridged cost statements give a true and fair view of the cost of production or cost of operation, cost of sales and margin for each of the products, services and activities covered by audit.

We confirm to the best of our knowledge and belief that -

COST STATEMENTS

1. We have fulfilled our responsibilities as set out in the terms of the audit engagement contained in the letter dated _____ for the preparation of cost statements and to ensure that the cost statements in accordance with the applicable laws and the Cost Accounting Standards (CASs) issued or that may be issued from time to time by the Institute of Cost Accountants of India, in particular to ensure that the cost statements give a true and fair view cost of production or cost of operation, cost of sales and margin for each of the products, services and activities under Cost Audit.

2. The list of cost accounting policies followed by the company in the preparation of cost statements as provided to you is complete and is issued with the approval of competent management.

3. We have corrected the misstatements in the cost statements reported by you in the course of audit. The effects of uncorrected misstatements, if any, are not material,

both individually and in the aggregate in the cost statements as a whole. A list of the uncorrected misstatements is attached to this letter.

MATTERS RELATING TO OPERATIONS

4. There is no change in the installed capacity, manufacturing or operation process or technology during the year as compared to previous year, which have not been disclosed to you.**

5. We have provided you with access to all production / service facilities required for the purpose of Cost Audit.

6. The capacity of Product(s)/Service(s) are determined in accordance with manufacturer's specifications or technical assessments. These specifications are current and are applicable to the conditions prevailing in the audit year.

7. Where we were unable to provide you information on materials used, processes employed etc. on grounds of confidentiality, we have provided you with adequate surrogate information to enable you to satisfy yourselves on the correct determination of costs.

COST MEASUREMENT AND ASSIGNMENT

8. Significant assumptions used by us in making cost estimates are reasonable. There is no change in the cost accounting system followed by the company for identification of cost centers / cost objects, cost drivers, accounting for materials, allocation and absorption of overheads, basis of inventory valuation system, and method of charging depreciation or amortization followed by the company as compared to previous year.

9. Where costs are spread over periods based on benefits received, significant assumptions made in this regard are reasonable. **

10. We have applied our best judgement in determining the amount of costs which are abnormal and non-recurring and excluded such amounts from costs.

11. The cost statements containing product/service/activity-wise cost details have been properly compiled and reconciled with financial accounts. No costs relating to prior periods have been included in the cost statements for the current year.

12. Losses have been distinguished from costs and are not included in the cost statements.

13. Fines, penalties, damages and similar levies paid to statutory authorities or other third parties are not included in cost.

14. All subsidies / grants or amounts of similar nature received / receivable by the company in respect of costs incurred have been disclosed to you and reduced from such costs.

15. All outstanding liabilities (including those of income tax, excise duty, wealth tax, VAT/sales tax, and other taxes and duties where applicable) and outstanding incomes and assets have been provided for in the accounts.

16. The inventory includes all goods which are the property of this company wherever located, including goods sent on consignment account to customers.

INFORMATION PROVIDED

17. We have provided you with -

    a) Access to all information of which we are aware that is relevant to the preparation of cost statements including cost records, documentation and other matters.

    b) Additional information that you have requested for the purpose of this audit.

    c) Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

    d) All particulars relating to utilization of material, labour and other items of cost relating to the products under Cost Audit have been recorded in the cost records and are reflected in the cost statements.

18. We have disclosed to you –

    a) All known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing cost statements.

    b) Details on all legal cases or other disputes pending, which would give rise to any costs other than those which have been disclosed in the cost statements and all demands made by the authorities not accepted by the company, assessments under dispute and pending litigations.

    c) All information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves

        - Management;
        - Employees who have significant roles in internal control; or
        - Others where the fraud could have a material effect on the financial statements.

d) The results of assessment of the risk that the cost statements may be materially misstated as a result of fraud.

e) All irregularities involving management or employees who have a significant role in the system of internal control that could have a material effect on the cost records.

f) The identity of the entity's related parties and all the related party relationships and transactions with them of which we are aware.

19. We have provided you with all documentary evidence in support of the bases adopted to determine the normal price in respect of related party transactions and inter-company transfer and there is no shifting of profits between units to the detriment of ordinary investors at large.

ADEQUACY OF SYSTEMS

20. We have provided you with complete documentation on the cost system presently deployed in the company and access to the database for querying and to generate reports.

21. There are no persistent deficiencies in the cost accounting system pointed out in earlier cost audit reports but not rectified.

22. We have provided you with access to the working of the budgeting process, significant assumptions made in the preparation of budgets, budget documents, control reports and action taken on variances from budget.

23. The internal audit of financial accounts and cost accounting records for the year under audit has been carried out and you have been provided with the terms of engagement of the Internal Auditor, the Audit Plan, the internal audit reports and other communications from the internal auditor.

For__________________ Ltd.
Name:
Designation:

* Strike out the words/sentences/para not applicable.

** In case of change, please give details including the impact on unit cost of production or cost of operation, cost of sales and margin of the company/factory/unit and Product/ Service wherever applicable.

Appendix –X

Factors Influencing Sample Size

FOR TEST OF CONTROLS

The following are factors that the auditor would consider when determining the sample size for tests of controls. These factors, which need to be considered together, assume the engagement team does not modify the nature of timing of tests of controls or otherwise modify the approach to substantive procedures in response to assessed risks.

Factor	Effect onSample Size
An increase in the extent to which the cost auditor's risk assessment takes into account relevant controls	**Increase**
An increase in the tolerable rate of deviation	**Decrease**
An increase in the expected rate of the deviation of the population to be tested	**Increase**
An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population	**Increase**
An increase in the number of sampling units in the population	**Negligible**

1. Extent to which the risk of material misstatement is reduced by the operating effectiveness of controls

The more assurance the engagement team intends to obtain from the operating effectiveness of controls, the lower it's assessment of the risk of material misstatement will be, and the larger the sample size will need to be. When the engagement team's assessment of the risk of material misstatement at the assertion level includes an expectation of the operating effectiveness of controls, the team is required to perform tests of controls. Other things being equal, the more the engagement team relies on the operating effectiveness of controls in the risk assessment, the greater is the extent of the tests of controls (and therefore, the sample size is increased).

2. The rate of deviation from the prescribed control activity the engagement team iswilling to accept (tolerable error)

The lower the rate of deviation that the engagement team is willing to accept, the larger the sample size needs to be

3. The rate of deviation from the prescribed control activity the engagement team expects to find in the population (expected error)

The higher the rate of deviation that the engagement team expects, the larger the sample size needs to be so as to be in a position to make a reasonable estimate of the actual rate of deviation. Factors relevant to the engagement team's consideration of the expected error rate include the team's understanding of the business (in particular, risk assessment procedures undertaken to obtain an understanding of internal control), changes in personnel or in internal control, the results of audit procedures applied in prior periods and the results of other audit procedures. High expected error rates ordinarily warrant little, if any, reduction of the assessed risk of material misstatement, and therefore in such circumstances tests of controls would ordinarily be omitted.

4. The engagement team's required confidence level

The greater the degree of confidence that the engagement team requires that the results of the sample are in fact indicative of the actual incidence of error in the population, the larger the sample size needs to be.

5.The number* of *sampling units in the population

For large populations, the actual size of the population has little, if any, effect on sample size. For small populations however, audit sampling is often not as efficient as alternative means of obtaining sufficient appropriate audit evidence.

FOR TEST OF DETAILS

The following are factors that the auditor would consider when determining the sample size for tests of details. These factors, which need to be considered together, assume the engagement team does not modify the approach to tests of controls or otherwise modify the nature of timing of substantive procedure in response to the assessed risks.

Factor	Effect onSample Size
An increase in the auditor's assessment of the risk of material misstatement	**Increase**
An increase in the use of substantive procedure directed at the same assertion	**Decrease**
An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population	**Increase**
An increase in tolerable misstatement	**Decrease**

An increase of the amount of misstatement the auditor expects to find in the population	**Increase**
Stratification of the population when appropriate	**Decrease**
The number of sampling units in the population	**Negligible**

1. The engagement team's assessment of the risk of material misstatement

The higher this is, the larger the sample size would need to be. The engagement team's assessment of the risk of material misstatement is affected by inherent risk and control risk. For example, if the engagement team does not perform tests of controls, the team's risk assessment cannot be reduced for the effective operation of internal controls with respect to the particular assertion.

Therefore, in order to reduce audit risk to an acceptably low level, the engagement team needs a low detection risk and will rely more on substantive procedures. The more audit evidence that is obtained from tests of details (that is, the lower the detection risk), the larger the sample size will need to be.

2. The use of other substantive procedures directed at the same assertion

The more the engagement team is relying on other substantive procedures (tests of details or substantive analytical procedures) to reduce to an acceptable level the detection risk regarding a particular item of cost, cost heads, class of transactions or account balance, the less assurance it will require from sampling and, therefore, the smaller the sample size can be

3. The engagement team's required confidence level

The greater the degree of confidence that the engagement team requires that the results of the sample are in fact indicative of the actual amount of error in the population, the larger the sample size needs to be

4. The total error the engagement team is willing to accept (tolerable error)

The lower the total error that the cost auditor is willing to accept, the larger the sample size needs to be.

5. The amount of error the engagement team expects to find in the population (expected error)

The greater the amount of error the engagement team expects to find in the population, the larger the sample size needs to be in order to make a reasonable estimate of the actual amount of error in the population. Factors relevant to the engagement team's consideration of the expected error amount include the extent, to which item values are determined subjectively, the results of risk assessment procedures, the results of tests of control, the results of audit procedures applied in prior periods, and the results of other substantive procedures.

6. *Stratification*

When there is a wide range (variability) in the monetary size of items in the population. It may be useful to group items of similar size into separate subpopulations or strata. This is referred to as stratification. When a population can be appropriately stratified the aggregate of the sample sizes from the strata generally will be less than the sample size that would have been required to attain a given level of sampling risk, had one sample been drawn from the whole population.

Appendix -XI

Indicative Areas for inclusion in Cost Audit Report

Given below are the indicative areas referred to in the cost audit report as well as other suggested area that may be considered by a cost auditor.

1. **Cost Centres / Cost Objects**

    - Approach followed for identifications of, cost objects, cost centre
    - Adequacy to the size, scale and type of operations
    - Effectiveness of the system followed for collection of costs and revenues
    - Cost objects requiring separate cost centre and / or sub cost centre.

2. **Budgetary System**

    - Adequacy to the size, scale and type of operations.
    - Frequency of Review
    - Linkage to Cost Information
    - Extent of Variance Analysis

3. **Management Information System (MIS)-**Coverage of cost information, analysis and review linked to operational decision making.

4. **Capacity Utilization Analysis** alongwith estimated impact on costs and profitability *(Product – wise, Product Group wise and Unit wise)***:**

    - Under-utilization of Capacities
    - Idle Capacities
    - Non-Productive Assets
    - Trend Analysis
    - Opportunity Analysis
    - Outsourcing / sub-contracting vs. internal Capacities
    - Plant break-down hours with impact on productivity, costs and profitability
    - Scope of Expansion and likely cost benefit analysis

5. **Productivity Analysis** alongwith estimated impact on costs and profitability *(Product – wise, Product Group wise and Unit wise)***:**

    - Production / Operations / Process Cycle Time and Productivity
    - Input-Output Analysis compared with Budgets or Standards or Industry Norms
    - Conversion Efficiency Analysis
    - Cost of wastages in operations

6. **Utilities / Energy Efficiency Analysis** *(Utility-wise, Unit wise, product Wise, and Product Group wise):*

    - ❖ Utility Productivity compared with Budgets and Standards or Industry Norms
    - ❖ Input-Output Efficiency –impact on costs and profitability
    - ❖ Energy Conversion Ratio highlighting wastages and inefficiency
    - ❖ Energy Consumption Ratio for each product / operations and each product / activity group compared with Budget or Standard of Industry norms.

7. **Inventory Analysis**

    - ❖ Basis of valuations & Consistency
    - ❖ Turnover efficiency: Cost of goods sold / Average Inventory
    - ❖ Return on Inventory; GM / Average Inventory, NM / Average Inventory
    - ❖ Slow moving or dead inventory
    - ❖ ABC analysis
    - ❖ Period holding analysis
    - ❖ Policy for insurance spares
    - ❖ Inventory holding due to changes in technology, changes in production process, obsolescence, etc

8. **Key Cost & Contribution Analysis**

    - ❖ Key – Expenses Ratios v. Cost of Production / Cost of Sales
    - ❖ Abnormal & Non Recurring Costs – impact on profitability
    - ❖ Key Costs Trend Analysis indicating estimated impact on future profitability
    - ❖ Cost Effectiveness Analysis: Cost of operations / Process vs. Benefits
    - ❖ Cost of Management vs. Net Turnover or Gross Margin or Net Margin
    - ❖ Cost Variance Analysis vs. Standards or Budgets – impact on profitability
    - ❖ Volume Variance Analysis vs. Standards or Budgets – impact on profitability
    - ❖ Marginal Cost and contribution Analysis for each product / activity group, each market segment, each customers segment, etc.
    - ❖ Service Department – wise cost trends (element- wise)

9. **Inputs Price Volatility** *(for key inputs only)* **–**

    - ❖ Name, whether Indigenous / Imported,
    - ❖ Total Value of Consumptions,
    - ❖ % to Total inputs,
    - ❖ 52 weeks high, low and company average,
    - ❖ FE variations impact, Derivatives Impact, etc.

10. **Product / Service Profitability** *(for key products / activities only)* –

- Product Turnover
- Gross Margin and Net Margin
- %age of Gross Margin to Turnover
- %age of Gross Margin to Capital Employed
- %age of Net Margin to Turnover
- %age of Net Margin to Capital Employed
- Foreign Exchange Variation Impact, Derivatives Impact, etc.

11. **Market / Customer Profitability-** Similaranalysis as above**:**

- Market Distribution – Indigenous vs. Overseas broken into smaller geographical divisions / segments
- Customer Distribution – In order of percentage share in each product / activity and in each product / activity group
- Indicate cost of servicing each market / customer and its efficiency in terms of business, contribution, gross / net margins, scope of sustainability, etc.
- Indicate cost of each supply chain vs. benefits
- Indicate impact of FTAs and dumping on each product, product group or each market / customer

12. **Price Sensitivity Analysis –** Impact on profitability**:**

- Up to 10% variations in key input's prices
- Up to 10% variations in key output's prices

13. **Working Capital Analysis**

- Movement of debtors vs. Credit Sales
- Days Debtor's Analysis- impact on cash flow and profitability
- Overseas Debtors- impact of likely Foreign Exchange Variations
- Movements of Creditors Vs. Credit Purchases
- Days Creditors Analysis – impact on supplies and product line
- Inventory Turnover
- Cash flow turnover- impact on profitability

14. **Manpower Analysis** *(Function wise, Unit wise, Product Wise and Product Group Wise):*

- Manpower Productivity vs. Returns compared with budgets or standard or Industry norms

- Manpower Pyramid- Ratio of Top management to Middle Management to officers to workmen to Contract Labour.
- Idle Man-hours to Total Man hours with reasons wise analysis and impact on productivity, costs and profitability
- Manpower Absenteeism vs. Total paid Man days
- Cost of Manpower Pyramid Analysis – broken into board categories (including contractual labour)
- Cost of Training to Total Employee Cost

15. **Environmental, Sustainability and Corporate Social Responsibility (CSR) Analysis (***Product Group Wise, Unit Wise and Company as a whole);*

- Actual Pollution Parameter compared with Regulatory *(national or international*) or Industry Norms
- Waste and Emission Control Costs vs. Cost of Production
- Preventive and other Environmental Management Costs Vs. Cost of Production
- Research and Development Costs relating to Environmental Issues vs. Cost of Production
- Domain Areas of Environment Affected (Air & Climate, Water, Soil, Ground water, Noise & Vibrations, Biodiversity & Landscape, Radiation)
- Usage of Renewable Energy vs. Total Energy (units and value)
- Ratio of Total Exports to total Imports
- Consumption of Indigenous Resources vs. Total Consumption
- Employments of Males vs. Female employees
- Costs of employees on training, welfare, health & safety, etc
- Payments made to the government (taxes, duties, etc.) vs. Total turnover
- Donations / Contributions for community Developments vs. Total Turnover, Gross Margin and Net Margin

16. **Risk Mapping Analysis** with impacts **o**n Costs , Profitability and Sustainability (*by Ratio Analysis*, Measures of Concentrations, Trend Analysis and Benchmarking);

- Product / Service lifecycle or failure
- Product Development
- Technological Changes
- Compliance to Regulatory Requirements – Action by Regulators
- Market Changes & Customer Satisfactions
- Competition from Existing / New Players
- Trademarks / Brand name erosion

- Outsourcing
- Natural Catastrophes and Environmental Factors
- Exchange Rate Movements
- Volume of Business with a particulars customer, suppliers, lender, grantor or contributor
- Revenue from particulars products or activities
- Sources of supply of materials used in operations
- Market or geographical area within which operations conducted
- Price war for competitors
- Obsolescence / Shrinkage

17. Future Financial Obligations

- Futures
- Derivatives
- Foreign Exchange Contracts
- Hedge Operations

18. Management Accounting Tools

Use of modern accounting tools and techniques such as Activity Based Costing, Target Costing, Lifecycle Costing, Quantity Costing, Value Engineering, Supply Chain Management, Balanced Scorecard, Performance Pyramid, Lean Accounting, Theory of Constraints, Throughput Accounting, Kaizen Costing, Customer Valuations, Strategic Cost Management, etc. and benefits availed, if any.

Cost Auditor's Report [draft]

We**, MSC Associates, Cost Accountants** having been appointed as Cost Auditor under section 148 of the Companies Act, 2013 of **M/s AXY Company Limited,** having its registered office at 75, Candid Street, JahawarNagar, Kaushik Road, Kolkata -700117 (hereinafter referred to as the company), have audited the books of account prescribed under clause section 128 of the said Act, and other relevant records in respect of Product manufactured and Services rendered by for the year ended 31st March, 2017 maintained by the company and report, in addition to our observations and suggestion in Para 2-

(i) We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purpose of this audit.

(ii) In our opinion, proper cost records, prescribed under Companies Act have been maintained by the company so as to give a true and fair view of the cost of production / operations, cost of sales and margin of the product / activity group under reference.

(iii) In our opinion, proper returns adequate for the purpose of the Cost Audit have been received from the branches not visited by us.

(iv) In our opinion and to the best of our information, the said books and records give the information required by the Companies Act, 2013, in the manner so required.

(v) In our opinion, said books and records are in conformity with the Cost Accounting Standards issued by Institute of Cost Accountants of India, to the extent these are found to be relevant and applicable.

(vi) In our opinion, company has adequate system of internal audit of cost records which to our opinion is commensurate to its nature and size of its business.

(vii) Detailed unit wise and product / activity wise cost statements and schedules thereto in respect of the product groups / activities under reference of the company duly audited and certified by us are kept in the company.

1. Cost Auditor's observations and suggestions

(a) We have conducted the audit in accordance with the Standards on Cost Auditing and Guidance Manual for Audit Quality issued by the Quality Review Board of the Institute of Cost Accountants of India and generally accepted auditing principles. An audit includes examining on a test basis, various Cost Accounting Records, Product Cost Statements and Annexure to the Cost Audit Report. We believe that our audit provides a reasonable basis for our opinion.

(b) The cost accounting records of the company are maintained in accordance with Generally Accepted Cost Accounting Principles and Cost Accounting Standards issued by the Institute of Cost Accountants of India to the extent these are found to be relevant and applicable. There has been no change in the system of cost accounting during the year under review and the same is being followed consistently by the company.

(c) In our opinion, the company has a well laid down Budgetary Control System.

(In case the company does not have a Budgetary Control System, the observations to be modified accordingly)

(d) The Available Capacity shown in Para 4(1) in respect of the different units and Product Groups are as certified by the management.

(e) Profit / loss as per Cost Accounting Records for the Product not in the cost audit reflected in the Reconciliation Statement of the company as a whole are not audited by us and the same is a s certified by the management.

(f) Cost of Production and Cost of Sales has been given for the Audited products as well as unaudited products/ activities. The figures for the unaudited product/ activities are as certified by the management.

(g) Normal Price (Para 10) and the basis adopted to determine the normal price are as certified by the management and have not been verified / audited by us.

(h) Reconciliation of Indirect Taxes for the company as a whole are based on the monthly returns submitted by the company to various authorities and prima facie reviewed by us, We have not carried out detailed audit process to verify the same. In respect of units not audited by us, the figures are as certified by the management.

(i) We have not come across any significant variation in the current year's figures, over the previous year's figures for various items under each para of the Annexure to the Cost Audit Report, other than the normal variations arising out of change in volume & product mix, which are justified by the management.

(This would be applicable when the company has been under audit during previous years also)

(j) The company has come under the purview of maintenance of cost records for the first time with effect from April 1, 2016 as well as for cost audit from that date. Consequently, previous year figures have not been provided.

(Applicable when the company comes under purview for the first time)

(k) The previous year(s) figures in respect of the different product have been recast and regrouped wherever necessary to meet the requirement of the Companies Act, 2013
(If applicable)

For MSC Associates

July 31, 2017 Cost Accountants
Kolkata Membership No. 123456

ANNEXURE TO THE COST AUDIT REPORT

2. Cost Accounting Policy

The Company controls its operations and activities through SAP-ERP systems. The books of accounts and other records have been designed to facilitate compliance of the relevant provisions of the Companies Act on one hand, and meet the internal requirements of information and systems for planning,review and internal control on the other hand. Financial and cost accounting are integrated. Cost Accounts are designed to adopt Costing Systems appropriate to the business carried out by the company incorporating the basic tenets and principles of Standard Costing and Budgetary Control.

(a) Identification of cost centres / cost objects and cost drivers

Each department / activities where cost is incurred directly are identified as cost centre. The expenses are accumulated under different cost centres classified as production cost centre, service cost centres, general works overheads, administrative overheads and selling & distribution overheads.

The cost of service cost centre viz. Water Treatment, Boiler, and Power are apportioned to the respective consuming cost centre on the basis of actual usage of the service.

(b) Accounting for material cost including packing materials, stores and spares etc., employee cost, utilities and other relevant cost components:

(i) The raw materials for manufacturing of different products viz. RM-1, RM-2,RM-3,RM-4,RM-5,RM-6 and RM-7 and other purchased materials, both indigenous and imported, are valued at weighted average landed cost net of input credited under Cenvat and VAT.

The entire materials accounting is computerized and all issue are identified with the concerned process / cost centre at the time of issue.

The stores and spares on consumption are directly charge to cost centre when the issue posting takes place.

(ii) The company has its own captive power plant and the entire generated power is consumed for its own productions.

(c) Accounting, allocation and absorption of overheads

Factory Overheads- Allcommonexpensesthat cannot be directly allocated to a production cost centre or a service cost centre are considered as Factory Overheads and are apportioned to the production service cost centres on the basis of Direct Employee Costs of the respective cost centre.

Administrative Overheads – Theoperationsof the company are located at locations A, B, and C. The expenses of corporate management, secretarial legal etc. are considered asAdministrative Overheads. Totaladministrative overheads areapportioned to the respective productions units on an equitable basis. The apportioned Administrative overheads are then allocated to individuals products manufactured at the units on the basis of sales quantity.

Selling and Distribution Overheads- The activities relating sales and marketing are classified as selling and distribution Overheads. These are identified separately for domestic and export operations. The common as well as separately identified selling and distribution overheads are allocated to the products on the basis of respective sales quantities.

(d) Accounting for Depreciation/Amortization

The company follow the straight line method of depreciation calculated at the rates computed in accordance with Schedule II of Companies Act, 2013. The depreciation identifiable to a particular cost centre is charged to that centre and included in the production overheads of the centre. Depreciation on the common assets is allocated to the respective overheads.

(e) Accounting for by- products / joint product, scraps, wastages etc.

The sales realization form waste / scrap arising out of the production process is credited to the Factory Overheads. There are no by- products or joint products.

(f) Basis for Inventory Valuation

The stores and material accounting is computerized, which captures the quantity and value of all materials received. Raw materials and other materials are valued at weighted average cost net of recoverable taxes and duties. Work-in-Progress and Finished products are valued on absorption cost basis.

Stores and spare parts are valued at cost, net of recoverable taxes and duties. Necessary provision is made and charged to revenue in case of identified obsolete and non moving item.

(g) Methodology for valuation of Inter-Unit / Inter Company and Related Party transactions.

The company has no Inter-unit transactions. Related Party transactions are made, if any, at arm's length price.

(h) Treatment of abnormal and non- recurring costs including classifications of other non-cost items.

Loss on obsolescence, demurrage charges, loss on sale of fixed assets, premium on foreign exchange forward contracts, loss / gain on forex etc. have been treated as non cost expenses and charged to costing profit and loss account.

(i) Other relevant cost accounting policy adopted by the Company

Nothing in particulars

The cost accounting records of the company are maintained in accordance with the generally accepted cost accounting principles and cost accounting standards issued by the Institute of Cost Accountants of India to the extent these are found to be relevant and applicable. There has been no change in the system of cost accounting being followed and the same is being followed consistently by the company.

The company has a well laid down budgetary control system. The annual business plan is split up into monthly period and actual are compared with budgets. Variance analysis in detail is done for the purpose of effective control of operations.

List of the Cost Auditing Standards / Standards on Cost Auditing

The following are the Standards of Auditing issued by Institute of Cost Accountants of India till March -17 are classified in two categories are; (1) **Mandatory** (Approved by Ministry of Corporate Affairs) 2. **Recommendatory** (Approved by Council of Institute of Cost Accountants of India)

Mandatory

CAS -101	*Planning an Audit of Cost Statements*
CAS -102	*Audit Documentation*
CAS -103	*OverallObjectives of the Independent Cost Auditor andthe Conduct of an Audit in Accordance with Cost Auditing Standards*
CAS -104	*Knowledge of Business, its Processes and the Business Environment*

Recommendatory

SCA- 105	*Agreeing the Terms of Cost Audit Engagements*
SCA- 106	*Audit Sampling*
SCA- 107	*Audit Evidence*
SCA- 108	*Materiality in Planning and Performing a Cost Audit*
SCA- 109	*Cost Auditor's Responsibility relating to Fraud in an Audit of Cost Statements*
SCA- 110	*Written Representations*
SCA- 111	*Evaluation of Misstatements identified during the Cost Audit*
SCA- 112	*Analytical Procedures*
SCA- 113	*Using the work of Internal Auditor*
SCA- 114	*Using the work of Cost Auditor's Expert*
SCA- 115	*Communication with Those Charged with Governance*
SCA- 116	*Communicating Deficiencies in Internal Control*
SCA- 117	*Identifying and Assessing the Risks of Material Misstatements*
SCA- 118	*The Cost Auditor's Responses to Assessed Risks*
SCA- 119	*Related Parties*