



SCA - 105
Standard on Cost Auditing
“Agreeing the Terms of Cost Audit Engagements”

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The following is the **Standard on Cost Auditing** on “**Agreeing the Terms of Cost Audit Engagements**”. In this Standard, the standard portions have been set in ***bold italic*** type. This Standard should be read in the context of the background material, which has been set in normal type.

1. Introduction

This Standard deals with the cost auditor’s responsibilities in agreeing the terms of the cost audit engagements with 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.

2. Objective

The objective of this standard is to enable the cost auditor to accept or continue a cost audit engagement only when the basis upon which it is to be performed has been agreed, through:

- (a) Establishing whether the preconditions for a cost audit are present; and*
- (b) Confirming that there is a common understanding between the cost auditor and management with the terms of cost audit engagement.*

3. Scope

This Standard 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. (Ref: Para. 6.1)

4. Definitions

The following terms are being used in this Standard with the meaning specified.

- 4.1 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.*
- 4.2 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.

- 4.3 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.*
- 4.4 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.*
- 4.5 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.*
- 4.6 Cost Statements:-***Cost Statements, in relation to an entity, includes*
- (i) quantitative details of capacity, production and sales;*
 - (ii) quantitative details of consumption of materials and other inputs;*
 - (iii) cost sheet showing element-wise 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) statement of value addition and distribution of earnings; and*
 - (vi) any explanatory note annexed to, or forming part of, any document referred to in (i) to (v) above.*
- 4.7 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.

- 4.8** *Institute: Institute means The Institute of Cost Accountants of India constituted under section 2(1)(f) of the Cost and Works Accountant Act, 1959 (23 of 1959).*
- 4.9** *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.*
- 4.10** *Preconditions for a Cost Audit: The use by management of an acceptable cost reporting framework in the preparation of the cost statements and the agreement of management to the premises on which a cost audit is conducted.*

5. Requirements

Preconditions for a Cost Audit

- 5.1** *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 (Ref: Para. 6.2-6.10)*
 - (b) Obtain the agreement from management that it acknowledges and understands its responsibility: (Ref: Para. 6.11-6.14, 6.20)*
 - 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; (Ref: Para. 6.15)*
 - ii) For selection and consistent application 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 (Ref: Para. 6.16-6.19)*
 - 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.*

Limitation on Scope Prior to Cost Audit Engagement Acceptance

- 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 required by law or regulation to do so.*

Other Factors Affecting Cost Audit Engagement Acceptance

- 5.3** *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, except as provided in paragraph 5.13; or*
 - (b) If the agreement referred to in paragraph 5.1(b) has not been obtained.*

Agreement on Cost Audit Engagement Terms

- 5.4** *The cost auditor shall agree to the terms of the cost audit engagement with management. (Ref: Para. 6.21)*
- 5.5** *Subject to paragraph 5.6 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: (Ref: Para. 6.22–6.25)*
- (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.*
- 5.6** *If law or regulation prescribes in sufficient detail the terms of the cost audit engagement referred to in paragraph 5.5, the cost auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities as set out in paragraph 5.1(b). (Ref: Para. 6.22& 6.25)*
- 5.7** *If law or regulation prescribes responsibilities of management similar to those described in paragraph 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 shall use the description in paragraph 5.1(b). (Ref: Para. 6.25)*

Recurring Cost Audits

- 5.8** *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. (Ref: Para. 6.26)*

Acceptance of a Change in the Terms of the Cost Audit Engagement

- 5.9** *The cost auditor shall not agree to a change in the terms of the cost audit engagement where there is no reasonable justification for doing so. (Ref: Para. 6.27–6.29)*
- 5.10** *If, prior to completing the cost audit engagement, the cost auditor is requested to change the cost audit engagement to an engagement that conveys a lower level of assurance, the cost auditor shall determine whether there is reasonable justification for doing so. (Ref: Para. 6.30–6.31)*



- 5.11** *If the terms of the cost 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 cost audit engagement and is not permitted by management to continue the original cost audit engagement, the cost auditor shall:*
- (a) Withdraw from the cost audit engagement where 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.*

Additional Considerations in Engagement Acceptance

Cost Accounting Standards Supplemented by Law or Regulation (Ref: Para. 6.32)

- 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.*

Cost Reporting Framework Prescribed under law or regulation - Other matters affecting acceptance

- 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: (Ref: Para. 6.33)*
- (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.*

5.15 *If the conditions outlined in paragraph 5.14 are not present and the cost auditor is required by law or regulation to undertake the cost audit engagement, the cost auditor shall:*

- (a) Evaluate the effect of the misleading nature of the cost statements on the cost auditor's report; and*
- (b) Include appropriate reference to this matter in the terms of the cost audit engagement.*

Cost Auditor's Report Prescribed by Law or Regulation

5.16 *In some cases, 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. In these circumstances, the cost auditor shall evaluate:*

- (a) Whether users might misunderstand the assurance obtained from the audit of the cost statements and if so,*
- (b) Whether additional explanation in the cost auditor's report can mitigate possible misunderstanding.*

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. (Ref: Para. 6.34)

6. Application Guidance



- 6.1 Cost audit engagements, may be accepted only when the cost audit practitioner considers that the relevant ethical requirements such as independence and professional competence will be satisfied, and when the engagement exhibits essential characteristics. The cost auditor's responsibilities in respect of ethical requirements in the context of the acceptance of a cost audit engagement and in so far as they are within the control of the cost auditor are addressed. (Ref: Para 3)

Preconditions for a Cost Audit

The Cost Reporting Framework (Ref: Para. 5.1(a))

- 6.2 A condition for acceptance of an engagement is that the criteria referred to in the scope of an engagement are suitable and available to intended users. Criteria are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Suitable criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. For purposes of the standard on cost auditing, the applicable cost reporting framework provides the criteria the cost auditor uses to audit the cost statements, including where relevant their fair presentation.
- 6.3 In the absence of an acceptable cost reporting framework, management does not have an appropriate basis for preparation of the cost statements and the cost auditor does not have suitable criteria for auditing the cost statements. The Cost Reporting Framework also ensures consistency in both the presentation of cost statements as well as in the performance of audit procedures. In many cases the cost auditor may presume that the applicable cost reporting framework is acceptable, as described in paragraphs 6.8 – 6.9.

Determining the Acceptability of the Cost Reporting Framework

- 6.4 Factors that are relevant to the cost auditor for determining acceptability of cost reporting framework to be applied in the preparation of the cost statements include:
- i) The nature of the entity (for example, whether it is a business enterprise, a public sector entity or a not-for-profit organization);
 - ii) The purpose of the cost statements (for example, whether they are prepared to meet the common cost information needs of a wide range of users or the cost information needs of specific users);
 - iii) The nature of the cost statements (for example, whether the cost statements are a complete set of cost statements or a single cost statement); and



- iv) Whether the cost statements are prepared as per the cost reporting framework mandated by any law or regulation.
- 6.5 Cost statements prepared within a cost reporting framework designed to meet the common cost information needs of a wide range of users are referred to as general purpose cost statements.
- 6.6 In some cases, the cost statements may be prepared in accordance with a cost reporting framework designed to meet the cost information needs of specific users. Such cost statements are referred to as special purpose cost statements. The cost information needs of the intended users will determine the applicable cost reporting framework in these circumstances.
- 6.7 Deficiencies in the applicable cost reporting framework that indicate that the framework is not acceptable may be encountered after the cost audit engagement has been accepted. When use of that framework is prescribed under law or regulation, the requirements of paragraphs 5.14–5.15 apply. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, as required by paragraph 5.11, new terms of the cost audit engagement are agreed to reflect the change in the framework as the previously agreed terms will no longer be valid.

General Purpose Framework

- 6.8 The cost accounting standards issued by the Institute as applicable are presumed to be acceptable for general purpose cost statements prepared by the entities. This is often identified as the applicable cost reporting framework in law or regulation governing the preparation of general purpose cost statements.

Cost Reporting Frameworks prescribed by Law or Regulation

- 6.9 In accordance with paragraph 5.1(a), the cost auditor is required to determine whether the cost reporting framework, to be applied in the preparation of the cost statements, is acceptable. For certain types of entities, Law or regulation prescribes the cost reporting framework to be used in the preparation of general purpose cost statements. In the absence of indications to the contrary, such a cost reporting framework is presumed to be acceptable for general purpose cost statements prepared by such entities. In the



event that the framework is not considered to be acceptable, paragraphs 5.14 –5.15 would apply.

The Companies that do not require to follow the prescribed Cost Reporting frameworks as per applicable Law or Regulation (Ref para 5.1 (a))

- 6.10 Where an entity is not required to follow the cost reporting framework prescribed under any law or regulation, the management identifies a cost reporting framework to be applied in the preparation of the cost statements. The cost auditor shall adhere to the Standards and Guidance note issued by the Institute from time to time for determining the acceptability of cost reporting frameworks in such circumstances.
- 6.11 Cost audit in accordance with standards on cost auditing is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph 5.1(b). The concept of an independent cost audit requires that the cost auditor's role does not involve taking responsibility for the preparation of the cost statements or for the entity's related internal control, and that the cost auditor has a reasonable expectation of obtaining the information necessary for the purpose of cost audit. Accordingly, the premise is fundamental to the conduct of an independent cost audit. In order to clearly establish the responsibilities of the management as well as the auditor with respect to the conduct of cost audit, an agreement defining the same should be entered into as referred in paragraphs 5.4–5.7.
- 6.12 The responsibilities for cost reporting may be divided between management and those charged with governance and will vary from entity to entity depending upon the size, structure & nature of activities carried on by the entity and any relevant law or regulation under which it operates. In most cases, management is responsible for execution while those charged with governance have oversight of management. In some cases, those charged with governance will have, or will assume, responsibility for approving the cost statements or monitoring the entity's internal control related to cost reporting. In larger or public entities, a subgroup of those charged with governance, such as an audit committee, may be charged with certain oversight responsibilities.
- 6.13 The cost auditor to request management to provide written representations that it has fulfilled certain responsibilities. It may therefore be appropriate to make management aware that receipt of such written representations will be expected to support other



cost audit evidence relevant to the cost statements or one or more specific assertions in the cost statements.

- 6.14 Where management will not acknowledge its responsibilities, or do not agree to provide the written representations, the cost auditor will be unable to obtain sufficient appropriate audit evidence. In such circumstances, it would not be appropriate for the cost auditor to accept the cost audit engagement, unless the law or regulation requires the cost auditor to do so. In cases where the cost auditor is required to accept the cost audit engagement, the cost auditor may need to explain to management the importance of these matters, and the implications for the cost auditor's report.

Preparation of the cost statements as applicable under the Law or Regulation [Ref: Para. 5.1(b) (i)]

- 6.15 Most cost reporting frameworks include requirements relating to the presentation of the cost statements; for such frameworks, preparation of the cost statements in accordance with the cost reporting framework includes presentation. In the case of a fair presentation framework the importance of the reporting objective of fair presentation is such that the premise agreed with management includes specific reference to fair presentation, or to the responsibility to ensure that the cost statements will "present fairly, in all material respects," or "give a true and fair view" in accordance with the cost reporting framework.

Internal Control [Ref: Para. 5.1(b) (iv)]

- 6.16 Management maintains such internal control as it determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error. However internal control, no matter how effective, can provide an entity with only reasonable certainty about achieving the entity's cost reporting objectives due to the inherent limitations of internal control.
- 6.17 An independent cost audit conducted in accordance with the standards on cost auditing does not act as a substitute for the maintenance of internal control necessary for the preparation of cost statements by management. Accordingly, the cost auditor is required to obtain the agreement of management that it acknowledges and understands its responsibility for internal control. However, the agreement required by paragraph 5(b) (ii) does not imply that the cost auditor will find that internal control maintained by management has achieved its purpose or will be free of deficiencies.



- 6.18 It is for management to determine what internal control is necessary to enable the preparation of the cost statements. The term “internal control” encompasses a wide range of activities within entities that may be described as the control environment; the entity’s risk assessment process; the information system, including the related business processes relevant to cost reporting, and communication; control activities; and monitoring of controls. This division, however, does not necessarily reflect how a particular entity may design, implement and maintain its internal control, or how it may classify any particular activity. An entity’s internal control (in particular, its books and records, or cost accounting systems) will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulation.
- 6.19 The law or regulation refers to the responsibility of management for the adequacy of books and records, or cost accounting systems. In some cases, general practice may assume a distinction between books and records or cost accounting systems on the one hand and internal control or controls on the other. As books and records, or cost accounting systems, are an integral part of internal control as referred to in paragraph 6.18, no specific reference is made to them in paragraph 5.1(b)(ii) for the description of the responsibility of management. To avoid misunderstanding, it may be appropriate for the cost auditor to explain to management the scope of this responsibility.

Considerations Relevant to Smaller Entities (Ref: Para. 5.1(b))

- 6.20 One of the purposes of agreeing the terms of the cost audit engagement is to avoid misunderstanding about the respective responsibilities of management and the cost auditor. For example, when a third party has assisted with the preparation of the cost statements, it may be useful to remind management that the preparation of the cost statements in accordance with the applicable cost reporting framework remains its responsibility.

Agreeing the Terms of the Cost Audit Engagement (Ref: Para. 5.4)

- 6.21 The roles of management in agreeing the terms of the cost audit engagement for the entity depend on the governance structure of the entity and relevant law or regulation.

Cost audit engagement letter or other form of written agreement (Ref: Para. 5.5–5.6)



6.22 It is in the interests of both the entity and the 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 that is, they prescribe the matters described in paragraph 5.5. Although in these circumstances paragraph 5.6 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 as set out in paragraph 5.1(b), the cost auditor may nevertheless consider it appropriate to include the matters described in paragraph 5.5 in an engagement letter for the information of management.

Form and Content of the Cost Audit Engagement Letter

6.23 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 103. Paragraphs 5.1(b) and 5.7 of this standard on cost auditing also deal with the description of responsibilities of the management. In addition to including the matters required by paragraph 5.5, 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 (see also paragraph 6.13).
- 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.

6.24 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.

An example of a cost audit engagement letter is set out in Appendix I.

Responsibilities of Management Prescribed by law or regulation (Ref: Para. 5.6–5.7)

6.25 If under any circumstances the cost auditor is of the opinion that it is not necessary to record certain terms of the cost audit engagement in cost audit engagement letter, the cost auditor is still required by paragraph 5.6 to seek the written agreement from management that it acknowledges and understands that its responsibilities as set out in paragraph 5.1(b). However, in accordance with paragraph 5.7, such written agreement may be in the format as prescribed by law or regulation if the audit is carried out under a legal framework and such law or regulation establishes responsibilities for management that are equivalent in effect to those described in paragraph 5.1(b). Institute, regulatory bodies of Government may have provided guidance as to whether the description in law or regulation is equivalent.

Recurring Cost Audits (Ref: Para. 5.8)

6.26 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.

Acceptance of a Change in the Terms of the Cost Audit Engagement

Request to Change the Terms of the Cost Audit Engagement (Ref: Para. 5.9)

- 6.27 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, as required by paragraph 5.9, may consider the justification given for the request, particularly the implications of a restriction on the scope of the cost audit engagement.
- 6.28 A change in circumstances that affects the entity's requirements or a difference in opinion or misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the cost audit engagement.
- 6.29 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.

Request to Change to a Review or a Related Service (Ref: Para. 5.9 and 5.10)



- 6.30 Before agreeing to change a cost audit engagement, cost auditor who was engaged to perform a cost audit in accordance with standards on cost auditing may need to assess, in addition to the matters referred to in paragraphs 6.28–6.30 above, any legal or contractual implications of the change.
- 6.31 If the cost auditor concludes that there is reasonable justification to change the cost audit engagement, the cost audit work performed to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement.

Additional Considerations in Engagement Acceptance

Cost Accounting Standards Supplemented by Law or Regulation (Ref: Para. 5.13)

- 6.32 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.

Cost Reporting Framework Prescribed by Law or Regulation—Other Matters affecting acceptance (Ref: Para. 5.14)

- 6.33 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.

Cost Auditor’s Report Prescribed by the Law or Regulation (Ref: Para.5.16)

- 6.34 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.



7. Effective Date

This Standard is effective for audits on or after

8. Statement of Modifications: Modifications to ISA 210, “Agreeing the Terms of Audit Engagements”

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

1. Change of ‘terms’ used in the ISAs that have corresponding meaning in cost audit vis-à-vis financial audit, such as Auditor with Cost Auditor, Audit with Cost Audit, Financial Statements with Cost Statements, Financial Reporting with Cost Reporting, Audit Procedures with Cost Audit Procedures, Auditor’s Responsibility with Cost Auditor’s Responsibility, etc.;
2. Corresponding modification in definitions of similar terms, examples used and in the Application Guidance;
3. Unlike the practice followed in ISAs, definitions of all ‘terms’ relevant to this SCA are reproduced.

Deletions:

1. Paragraph(A25) on “Audits of Components” has been deleted as the same is not relevant to the Audit of Cost Statements in Indian context.



Appendix I

(Ref: Para. 6.23–6.24)

Example of 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 this standard. It may be appropriate to seek legal advice that any proposed letter is suitable.

The Board of Directors¹

[or those charged with governance]

ABC Company

[The objective and scope of the cost audit]

You² 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]

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

¹The addresses and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction.

²Throughout 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.

³Details comprising cost statements may be amended as required under the applicable cost reporting framework, or as prescribed by law or regulation.

⁴Where 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.



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 this standard 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;
- (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]



Cost Auditing and Assurance Standards Board

[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