



SCA -111
Standard on Cost Auditing
“Evaluation of Misstatements identified during the Cost Audit”

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Statement of Modifications

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

1. Introduction

The purpose of this Standard is to 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.

2. Objective

The objective of this standard is to enable cost auditor to evaluate:

- (a) The effect of misstatements identified during the cost audit; and***
- (b) The effect of uncorrected misstatements, if any, on the cost statements.***

3. Scope

This Standard 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.

4. Definitions

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

- 4.1 Audit documentation: 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.***
- 4.2 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.***
- 4.3 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 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.*
- 4.5 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.*
- 4.6 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.*
- 4.7 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. (Refer Para 6.1)

- 4.8 Overall Audit Strategy: Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the detailed audit plan.**
- 4.9 Those charged with governance: The person(s) or organization (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. 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.**
- 4.10 Uncorrected misstatements: Misstatements that the cost auditor has accumulated during the audit and that have not been corrected.**
- 4.11 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.**

5. Requirements

Accumulation of Identified Misstatements (Refer Para 6.2 – 6.3)

- 5.1 The cost auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial.**

Consideration of Identified Misstatements as the Audit Progresses (Refer Para 6.4 -6.5)

- 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.*

Communication and Correction of Misstatements (Refer Para 6.6 – 6.9)

- 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.*

Evaluating the Effect of Uncorrected Misstatements (Refer Para 6.10 – 6.19)

- 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.*

Communication with Those Charged with Governance (Refer Para 6.20 – 6.22)

- 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.*

Written Representations (Refer Para 6.23)

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.*

Documentation (Refer Para 6.24)

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.*

6. Application Guidance

Definition of Misstatement (Refer Para 4.7)

6.1 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.

Accumulation of Identified Misstatements (Refer Para 5.1)

6.2 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.

6.3 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(ED).*

Consideration of Identified Misstatements as the Audit Progresses (Refer Para 5.2)

6.4 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.

6.5 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.

Communication and Correction of Misstatements (Refer Para 5.3 – 5.5)

6.6 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.

6.7 The cost auditor may request management to examine the nature of misstatement and understand the cause of a misstatement identified by the cost auditor, perform procedures to determine the amount of the actual misstatement or extent of disclosure, and to make appropriate corrections to the cost statements. Such a request may be



made, for example, based on the auditor's projection of misstatements identified in an audit sample to the entire population from which it was drawn.

- 6.8** 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.
- 6.9** 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.

Evaluating the Effect of Uncorrected Misstatements (Refer Para 5.6)

- 6.10** Prior to evaluating the effect of uncorrected misstatements, it may be necessary for the cost auditor to reassess and revise materiality based on the actual cost results because materiality determination during the course of planning and performing cost audit is often based on the estimates of the entity's cost.
- 6.11** The Standard explains that, as the cost audit progresses, materiality for the cost statements as a whole (and, if applicable, the materiality level or levels for particular items of cost, cost heads or disclosures) may have to be revised as a result of a change in circumstances that occurred during the cost audit.
- 6.12** Each individual misstatement is examined to evaluate its effect on the materiality level or levels for particular item of cost and whether the materiality level for that particular item of cost, has been exceeded. If an individual misstatement is judged to be material, it is unlikely that it can be offset by other misstatements.
- 6.13** The risk due to further undetected misstatements may be considered before offsetting even immaterial misstatements.
- 6.14** 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.



6.15 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 requirements;
- Affects compliance with 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).

6.16 These circumstances are only examples; not all are likely to be present in all situations nor is the list exhaustive. The existence of any circumstances such as these does not necessarily lead to a conclusion that the misstatement is material.

6.17 The implications of a misstatement that is, or may be, the result of fraud ought to be considered in relation to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements.

6.18 The cumulative effect of immaterial uncorrected misstatements related to prior periods may have a material effect on the current period's cost statements. There are different acceptable approaches to the cost auditor's evaluation of such uncorrected misstatements on the current period's cost statements. Using the same evaluation approach provides consistency from period to period.



Considerations Specific to Regulated Entities

6.19 In the case of cost audit of regulated entities, the evaluation whether a misstatement is material may also be affected by the cost auditor's responsibilities established by law, regulation or other authority to report specific matters.

Communication with Those Charged with Governance (Ref: Para. 5.7 – 5.8)

6.20 The auditor has to communicate the uncorrected misstatements with those charged with the governance of the entity, requesting them to make necessary corrections. However such communication is not necessary where he is prohibited to do so by any law or regulation.

6.21 The cost auditor has also to communicate the effect of uncorrected misstatements, individually as well as in aggregate, may have on his opinion in the cost audit report.

6.22 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.

Written Representations (Ref: Para. 5.9)

6.23 The cost auditor is required to request management and, where appropriate, those charged with governance to provide a written representation about uncorrected misstatements. In some circumstances, they may not believe that certain uncorrected misstatements are misstatements and may want to add to their written representation words such as: "We do not agree that items ... and ... constitute misstatements because [description of reasons]." Obtaining this representation does not, however, relieve the auditor of the need to form a conclusion on the effect of uncorrected misstatements.

Documentation (Ref: Para. 5.10)

6.24 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.



7. Effective Date

This Standard is effective for audits on or after _____.

8. Statement of Modifications: Modifications to ISA 450, “Evaluation of Misstatements identified during the Audit”

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:

- 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.;
- Corresponding modification in definitions of similar terms, examples used and in the Application Guidance;
- Unlike the practice followed in ISAs, definitions of all ‘terms’ relevant to this SCA are reproduced.

Addition:

- Paragraph on “Considerations Specific to Regulated Entities” (Paragraph 6.19) has been added to give effect to prevailing regulatory framework for audit of cost statements in Indian context.

Deletions:

- Paragraphs (A18 & A19) on “Considerations Specific to Public Sector Entities” have been deleted as those are not relevant to the Audit of Cost Statements in Indian context.
