



SCA -118
Standard on Cost Auditing
“The Cost Auditor’s Responses to Assessed Risks”
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The following is the **Standard on Cost Auditing, “The Cost auditor’s Responses to Assessed Risks”**. 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

- 1.1** The cost auditor performs risk assessment procedures (which include obtaining an understanding of an 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.
- 1.2** This Standard on Cost Auditing 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.

2. Objectives

The objective of this standard is to enable the cost auditor to design and Implement appropriate responses to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement in audit of cost statements.

3. Scope

This Standard on Cost Auditing (SCA) deals with the cost auditor’s responsibility to design and implement responses to the risks of material misstatement identified and assessed in an audit of cost statements.

4. Definitions

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

- 4.1 *Analytical Procedures: Evaluations of cost information through analysis of plausible 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.***
- 4.2 *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.***



- 4.3 Assertions: Representations by management, explicit or otherwise, that are embodied in the cost statements, as used by the cost auditor to consider the different types of potential misstatements that may occur.**
- 4.4 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.**
- 4.5 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.**
- 4.6 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.**
- 4.7 Auditor: Auditor is used to refer to the person or persons conducting the audit, usually the audit partner or other members of the audit team, or, as applicable the firm. Auditor includes Cost Auditor**
- 4.8 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.**
- 4.9 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.**
- 4.10 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.**
- 4.11 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.

4.12 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.*

4.13 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.

4.14 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 cost and 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.

4.15 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.

4.16 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. Misstatements can arise from error or fraud.



- 4.17 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.*
- 4.18 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.*
- 4.19 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).*
- 4.20 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.*
- 4.21 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.*

5. Requirements

Overall Responses

5.1 *The cost auditor shall design and implement overall responses to address the assessed risks of material misstatement at the cost statement level. (Ref: Para.6.1 – 6.3)*

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

5.2 *The cost auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level. (Ref: Para. 6.4 – 6.8)*



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 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 (Ref: Para. 6.9 – 6.17)**
- b) Obtain more persuasive audit evidence if the cost auditor's assessment of risk is higher. (Ref: Para. 6.18)**

Tests of Controls

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. (Ref: Para. 6.19-6.23)**

5.5 In designing and performing tests of controls, the cost auditor shall obtain more persuasive audit evidence if the auditor places greater reliance on the effectiveness of a control. (Ref: Para. 6.24)

Nature and Extent of Tests of Controls

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. (Ref: Para. 6.25-6.28)**



- 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. (Ref: Para. 6.29 -6.30)**

Timing of Tests of Controls

5.7 The cost auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls, subject to paragraphs 5.8 and 5.11 below, in order to provide an appropriate basis for the cost auditor's intended reliance. (Ref: Para. 6.31)

Using audit evidence obtained during an interim period

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 subsequent to the interim period; and**
- b) Determine the additional audit evidence to be obtained for the remaining period. (Ref: Para. 6.32 – 6.33)**

Using audit evidence obtained in previous audits

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. (Ref: Para. 6.34)**



5.10 If the cost auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the cost auditor shall establish the continuing relevance of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit. The cost auditor shall obtain this evidence by performing inquiry combined with observation or inspection, to confirm the understanding of those specific controls, and:

- a) If there have been changes that affect the continuing relevance of the audit evidence from the previous audit, the cost auditor shall test the controls in the current audit. (Ref: Para. 6.35)**
- b) If there have not been such changes, the cost auditor may test the controls at least once in every third audit. The cost auditor shall test some controls in each audit to avoid the possibility of testing all the controls on which the cost auditor intends to rely in a single audit period with no testing of controls in the subsequent two audit periods. (Ref: Para. 6.36 – 6.38)**

Controls over significant risks

5.11 If the cost auditor plans to rely on controls over a risk which the cost auditor has determined to be a significant risk, the cost auditor shall test those controls in the current period.

Evaluating the Operating Effectiveness of Controls

5.12 When evaluating the operating effectiveness of relevant controls, the cost auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective. (Ref: Para. 6.39)

5.13 If deviations from controls upon which the cost auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether: (Ref: Para. 6.40)

- a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;**
- b) Additional tests of controls are necessary; or**
- c) The potential risks of misstatement need to be addressed using substantive procedures.**



Substantive Procedures

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. (Ref: Para. 6.41-6.46)

5.15 The cost auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures. (Ref: Para. 6.47-6.50)

Substantive Procedures Related to the Cost Statement Closing Process

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. (Ref: Para. 6.51)**

Substantive Procedures Responsive to Significant Risks

5.17 If the cost auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the cost auditor shall 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. (Ref: Para. 6.52-6.53)

Timing of Substantive Procedures

5.18 If substantive procedures are performed at an interim date, the cost auditor shall cover the remaining period by performing:

- a) substantive procedures, combined with tests of controls for the intervening period; or**
- b) if the cost auditor determines that it is sufficient, further substantive procedures only,**

that provides a reasonable basis for extending the audit conclusions from the interim date to the period end. (Ref: Para. 6.54-6.56)

5.19 If misstatements that the cost auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor shall evaluate whether the related assessment of risk and the planned nature, timing or extent of substantive procedures covering the remaining period need to be modified. (Ref: Para. 6.57)



Adequacy of Presentation and Disclosure

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. (Ref: Para. 6.59)

Evaluating the Sufficiency and Appropriateness of Audit Evidence

5.21 Based on the audit procedures performed and the audit evidence 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. (Ref: Para. 6.59)

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. (Ref: Para. 6.60)

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. (Ref: Para. 6.61)

Documentation

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. (Ref: Para. 6.62)**

5.25 If the cost auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor shall include in the audit documentation the conclusions reached about relying on such controls that were tested in a previous audit.

5.26 The cost auditor's documentation shall demonstrate that the cost statements agree or reconcile with the cost records.

6. Application Guidance

Overall Responses (Ref: Para. 5.1)

6.1 Overall responses to address the assessed risks of material misstatement at the cost statement level may include:



- a) Emphasizing to the engagement team the need to maintain professional skepticism.
 - b) Assigning more experienced staff or those with special skills or using experts.
 - c) Providing more supervision.
 - d) Incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
 - e) Making general changes to the nature, timing or extent of audit procedures. For example: performing substantive procedures at the period end instead of at an interim date; or modifying the nature of audit procedures to obtain more persuasive audit evidence.
- 6.2 The assessment of the risks of material misstatement is affected by the cost auditor's understanding of the entity's control environment. An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity and thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at the period end.
- Deficiencies in the control environment, however, have the opposite effect; for example, the cost auditor may respond to an ineffective control environment by:
- a) Conducting more audit procedures as of the period end rather than at an interim date.
 - b) Obtaining more extensive audit evidence from substantive procedures.
 - c) Increasing the number of locations to be included in the audit scope.
- 6.3 Such considerations, therefore, have a significant bearing on the cost auditor's general approach, for example, an emphasis on substantive procedures (substantive approach), or an approach that uses tests of controls as well as substantive procedures (combined approach).

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level

The Nature, Timing and Extent of Further Audit Procedures (Ref: Para. 5.2)

- 6.4 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.

However, irrespective of the approach selected, the cost auditor designs and performs substantive procedures for each material items of cost in the cost statement, and disclosure.

- 6.5 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.
- 6.6 Timing of an audit procedure refers to when it is performed, or the period or date to which the audit evidence applies.
- 6.7 Extent of an audit procedure refers to the quantity to be performed, for example, a sample size or the number of observations of a control activity.
- 6.8 Designing and performing further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level provides a clear linkage between the auditor's further audit procedures and the risk assessment.

Responding to the Assessed Risks at the Assertion Level (Ref: Para. 5.3(a))

Nature

- 6.9 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 counterparty, 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 tests of controls and substantive procedures may be most responsive to assess the assertions made with respect to the completeness and accuracy.
- 6.10 The reasons for the assessment given to a risk are relevant in determining the nature of audit procedures. For example, if an assessed risk is lower because of the particular



characteristics of a class of transactions without consideration of the related controls, then the cost auditor may determine that substantive analytical procedures alone provide sufficient appropriate audit evidence. On the other hand, if the assessed risk is lower because of internal controls, and the cost auditor intends to base the substantive procedures on that low assessment, then the cost auditor performs tests of those controls, as required by paragraph 5.4(a). This may be the case, for example, for a class of transactions of reasonably uniform, non-complex characteristics that are routinely processed and controlled by the entity's information system.

Timing

- 6.11 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.
- 6.12 On the other hand, performing audit procedures before the period end may assist the cost auditor in identifying significant matters at an early stage of the audit, and consequently resolving them with the assistance of management or developing an effective audit approach to address such matters.
- 6.13 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.
- 6.14 Further relevant factors that influence the cost auditor's consideration of when to



perform audit procedures include the following:

- a) The control environment.
- b) When relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times).
- c) The nature of the risk (for example, if cost is being overstated in some products or material cost wherever absorbed on standard basis, price differences, if any based on negotiations made later on not considered while booking the costs, the auditor may wish to examine contracts available on the date of the period end).
- d) The period or date to which the audit evidence relates.

6.15 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.

6.16 The use of computer-assisted audit techniques (CAATs) may enable more extensive testing of electronic transactions and account files, which may be useful when the cost auditor decides to modify the extent of testing, for example, in responding to the risks of material misstatement due to fraud. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.

Considerations specific to smaller entities

6.17 In the case of very small entities, there may not be many control activities that could be identified by the cost auditor, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures. In some rare cases, however, the absence of control activities or of other components of control may make it impossible to obtain sufficient appropriate audit evidence.



Higher Assessments of Risk (Ref: Para 5.3(b))

6.18 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.

Tests of Controls

Designing and Performing Tests of Controls (Ref: Para. 5.4)

6.19 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.

6.20 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 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.

6.21 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 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/ standard and actuals.
- 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.

6.22 In addition, the auditor may design a test of controls to be performed concurrently with a test of details on the same transaction. Although the purpose of a test of controls is different from the purpose of a test of details, both may be accomplished concurrently



by performing a test of controls and a 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 an invoice to determine whether it has been approved and to provide substantive audit evidence of a transaction. A dual-purpose test is designed and evaluated by considering each purpose of the test separately.

- 6.23 In some cases, the cost auditor may find it impossible to design effective substantive procedures that by themselves provide sufficient appropriate audit evidence at the assertion level. This may occur when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system. In such cases, paragraph 5.4(b) requires the cost auditor to perform tests of relevant controls.

Audit Evidence and Intended Reliance (Ref: Para. 5.5)

- 6.24 A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

Nature and Extent of Tests of Controls

Other audit procedures in combination with inquiry (Ref: Para. 5.6(a))

- 6.25 Inquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with inquiry. In this regard, inquiry combined with inspection or re-performance may provide more assurance than inquiry and observation, since an observation is pertinent only at the point in time at which it is made.
- 6.26 The nature of the particular control influences the type of procedure required to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is evidenced by documentation, the cost auditor may decide to inspect it to obtain audit evidence about operating effectiveness. For other controls, however, documentation may not be available or relevant. For example, documentation of operation may not exist for some factors in the control environment, such as assignment of authority and responsibility, or for some types of control activities, such as control activities performed by a computer. In such circumstances, audit evidence about operating effectiveness may be obtained through inquiry in combination with other audit procedures such as observation or the use of CAATs.

Extent of tests of controls

- 6.27 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.
- e) The extent to which audit evidence is obtained from tests of other controls related to the assertion.

6.28 Because of the inherent consistency of IT processing, it may not be necessary to increase the extent of testing of an automated control. An automated control can be expected to function consistently unless the program (including the tables, files, or other permanent data used by the program) is changed. Once the cost auditor determines that an automated control is functioning as intended (which could be done at the time the control is initially implemented or at some other date), the cost auditor may consider performing tests to determine that the control continues to function effectively. Such tests might include determining that:

- a) Changes to the program are not made without being subject to the appropriate program change controls;
- b) The authorized version of the program is used for processing transactions;
- c) Other relevant general controls are effective; and
- d) Such tests also might include determining that changes to the programs have not been made, as may be the case when the entity uses packaged software applications without modifying or maintaining them. For example, the cost auditor may inspect the record of the administration of IT security to obtain audit evidence that unauthorized access has not occurred during the period.

Testing of indirect controls (Ref: Para. 5.6(b))

6.29 In some circumstances, it may be necessary to obtain audit evidence supporting the effective operation of indirect controls. For example, when the cost auditor decides to test the effectiveness of a user review of supplementary budgets detailing spends in excess of approved budgets the user review and related follow up is the control that is directly of relevance to the auditor. . Controls over the accuracy of the information in the reports (for example, the general IT controls) are described as “indirect” controls.

6.30 Because of the inherent consistency of IT processing, audit evidence about the



implementation of an automated application control, when considered in combination with audit evidence about the operating effectiveness of the entity's general controls (in particular, change controls), may also provide substantial audit evidence about its operating effectiveness.

Timing of Tests of Controls

Intended period of reliance (Ref: Para. 5.7)

6.31 Audit evidence pertaining only to a point in time may be sufficient for the cost auditor's purpose, for example, when testing controls over the entity's physical inventory counting at the period end. If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of the entity's monitoring of controls.

Using audit evidence obtained during an interim period (Ref: Para. 5.8(b))

6.32 Relevant factors in determining what additional audit evidence to obtain about controls that were operating during the period remaining after an interim period, include:

- a) The significance of the assessed risks of material misstatement at the assertion level.
 - b) The specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information system, processes, and personnel.
 - c) The degree to which audit evidence about the operating effectiveness of those controls was obtained.
 - d) The length of the remaining period.
 - e) The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls.
 - f) The control environment.
- 6.33 Additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the entity's monitoring of controls.
- 6.34 In certain circumstances, 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 auditor may have determined that an automated control was functioning as intended. The auditor may obtain audit evidence to determine whether changes to the automated control have been made that affect its continued effective functioning through, for example, inquiries of management and the inspection of logs to indicate what controls have been



changed. Consideration of audit evidence about these changes may support either increasing or decreasing the expected audit evidence to be obtained in the current period about the operating effectiveness of the controls. (Ref: Para. 5.9)

Controls that have changed from previous audits (Ref: Para. 5.10(a))

6.35 Changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. For example, changes in a system that enable an entity to receive a new report from the system probably do not affect the relevance of audit evidence from a previous audit; however, a change that causes data to be accumulated or calculated differently does affect it.

Controls that have not changed from previous audits (Ref: Para. 5.10(b))

6.36 The cost auditor's decision on whether to rely on audit evidence obtained in previous audits for controls that:

- a) have not changed since they were last tested; and
- b) are not controls that mitigate a significant risk,

is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment, but is required by paragraph 5.10 (b) to be at least once in every third year.

6.37 In general, the higher the risk of material misstatement, or the greater the reliance on controls, the shorter the time period elapsed, if any, is likely to be. Factors that may decrease the period for retesting a control, or result in not relying on audit evidence obtained in previous audits at all, include the following:

- a) A deficient control environment.
- b) Deficient monitoring of controls.
- c) A significant manual element to the relevant controls.
- d) Personnel changes that significantly affect the application of the control.
- e) Changing circumstances that indicate the need for changes in the control.
- f) Deficient general IT controls.

6.38 When there are a number of controls for which the cost auditor intends to rely on audit evidence obtained in previous audits, testing some of those controls in each audit provides corroborating information about the continuing effectiveness of the control environment. This contributes to the auditor's decision about whether it is appropriate to rely on audit evidence obtained in previous audits.

Evaluating the Operating Effectiveness of Controls (Ref: Para. 5.12 – 5.13)

6.39 A material misstatement detected by the cost auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.



6.40 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 cost auditor.

Substantive Procedures (Ref: Para. 5.14)

6.41 The cost auditor has to design and perform substantive procedures for each material item of cost in the cost statement, and disclosure, irrespective of the assessed risks of material misstatement. This requirement reflects the facts that:

- a) the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and
- b) there are inherent limitations to internal control, including management override.

Nature and Extent of Substantive Procedures (Ref: Para. 5.14)

6.42 Depending on the circumstances, the cost auditor may determine that:

- a) Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
- b) Only tests of details are appropriate.
- c) A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

6.43 Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.

6.44 The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a cost statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant cost statement amount and investigating whether they are included.

6.45 Because the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk.



6.46 In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing.

Considering Whether External Confirmation Procedures Are to Be Performed (Ref: Para. 5.15)

6.47 External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. Situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement may include, inventories held by third parties at bonded warehouses for processing or on consignment.

6.48 Although external confirmations may provide relevant audit evidence relating to certain assertions, there are some assertions for which external confirmations provide less relevant audit evidence. For example, external confirmations provide less relevant audit evidence relating to the recoverability of raw materials supplied to third part for job work purpose, than they do of their existence.

6.49 The cost auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for raw materials supplied to third part for job work purpose often include requests for information relevant to other cost statement assertions. Such considerations may influence the cost auditor's decision about whether to perform external confirmation procedures.

6.50 Factors that may assist the cost auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

- a) The confirming party's knowledge of the subject matter – responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- b) The ability or willingness of the intended confirming party to respond – for example, the confirming party:
 - (i) May not accept responsibility for responding to a confirmation request;
 - (ii) May consider responding too costly or time consuming;
 - (iii) May have concerns about the potential legal liability resulting from responding;
 - (iv) May account for transactions in different currencies; or
 - (v) May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual



manner or may attempt to restrict the reliance placed on the response.

- c) The objectivity of the intended confirming party – if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

Substantive Procedures Related to the Cost Statement Closing Process (Ref: Para. 5.16)

6.51 The nature, and also the extent, of the auditor's examination, of cost records and other adjustments depends on the nature and complexity of the entity's cost reporting process and the related risks of material misstatement.

Substantive Procedures Responsive to Significant Risks (Ref: Para. 5.17)

6.52 The cost auditor is required to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the cost auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.

6.53 In most cases, audit evidence from a previous audit's substantive procedures provides little or no audit evidence for the current period. There are, however, exceptions, for example, a legal opinion obtained in a previous audit related to the structure of a securitization to which no changes have occurred, may be relevant in the current period. In such cases, it may be appropriate to use audit evidence from a previous audit's substantive procedures if that evidence and the related subject matter have not fundamentally changed, and audit procedures have been performed during the current period to establish its continuing relevance.

Using audit evidence obtained during an interim period (Ref: Para. 5.18)

6.54 In some circumstances, the cost auditor may determine that it is effective to perform substantive procedures at an interim date, and to compare and reconcile information obtained at the period end with the comparable information at the interim date to:

- a) Identify amounts that appear unusual;
 - b) Investigate any such amounts; and
 - c) Perform substantive analytical procedures or tests of details to test the intervening period.
- 6.55 Performing substantive procedures at an interim date without undertaking additional procedures at a later date increases the risk that the cost auditor will not detect misstatements that may exist at the period end. This risk increases as the remaining period is lengthened. Factors such as the following may influence whether to perform substantive procedures at an interim date:
- a) The control environment and other relevant controls.



- b) The availability at a later date of information necessary for the auditor's procedures.
- c) The purpose of the substantive procedure.
- d) The assessed risk of material misstatement.
- e) The nature of the head of cost and related assertions.
- f) The ability of the auditor to perform appropriate substantive procedures or substantive procedures combined with tests of controls to cover the remaining period in order to reduce the risk that misstatements that may exist at the period end will not be detected.

- 6.56 Factors such as the following may influence whether to perform substantive analytical procedures with respect to the period between the interim date and the period end, whether the information system relevant to cost reporting will provide information concerning the cost of sales and margin for each product or service at the period end and the transactions in the remaining period that is sufficient to permit investigation of:
- a) Significant unusual transactions or entries (including those at or near the period end);
 - b) Other causes of significant fluctuations, or expected fluctuations that did not occur; and
 - c) Changes in the composition of the heads of cost or classification of items of cost.

Misstatements detected at an interim date (Ref: Para. 5.19)

- 6.57 When the cost auditor concludes that the planned nature, timing or extent of substantive procedures covering the remaining period need to be modified as a result of unexpected misstatements detected at an interim date, such modification may include extending or repeating the procedures performed at the interim date at the period end.

Adequacy of Presentation and Disclosure (Ref: Para. 5.20)

- 6.58 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.

Evaluating the Sufficiency and Appropriateness of Audit Evidence (Ref: Para. 5.21–5.23)

- 6.59 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 reevaluate 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.

6.60 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.

6.61 The cost auditor's judgment as to what constitutes sufficient appropriate audit evidence is influenced by such factors as the following:

- a) 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.
- b) Effectiveness of management's responses and controls to address the risks.
- c) Effectiveness of management's responses and controls to address the risks.
- d) Results of cost audit procedures performed, including whether such audit procedures identified specific instances of fraud or error.
- e) Source and reliability of the available information.
- f) Persuasiveness of the audit evidence.
- g) Understanding of the entity and its environment, including the entity's internal control.

Documentation (Ref: Para. 5.24)

6.62 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.

7. Effective Date

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



8. Statement of Modifications: Modifications to ISA 330, “The Cost Auditor’s Responses to Assessed Risks”

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

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

Deletions:

- Paragraph (A17) has been deleted as the same is extraneous to the Audit of Cost Statements in Indian context.
