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Exposure Draft

Revised Standards on Cost Auditing (SCAs)



Cost Auditing and Assurance Standards Board

The Institute of Cost Accountants of India

(Statutory body under an Act of Parliament)

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STANDARDS ON COST AUDITING

Introduction to the Standards on Cost Auditing

Standards on Cost Auditing are essential to ensure quality, efficiency and effectiveness of cost audit. These are means to evaluate whether the cost auditor has fulfilled his professional responsibilities to the satisfaction of all stakeholders. Standards guide how cost audit firms should structure their practice; how to conduct professional engagements; how to improve the quality of cost audit & reporting; and how to train their professional staff. These standards have the effect of dictating cost auditors' activities and behavior. They also provide a benchmark that facilitates the calibration of a cost auditor's legal liability in the event of substandard audit.

Legal Provisions with respect to Standards on Cost Auditing

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

Objectives of Standards on Cost Auditing

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

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

In order to achieve the overall objectives of audit the cost auditor is required to comply with the requirements of Standards on Cost Auditing in conjunction with Cost



Accounting Standards (CASs), Generally Accepted Cost Accounting Principles (GACAP), applicable Laws and Regulations, Ethical and Moral Requirements, Code of Conduct, and Institute Guidelines for audit of cost statements.

Purpose and Compliance Requirements of the Standards on Cost Auditing

- The cost auditor shall comply with the relevant ethical requirements including those pertaining to independence in respect of cost audit engagements.
- While conducting an audit, the cost auditor shall comply with each of the Standards on Cost Auditing relevant to the audit. A Standard on Cost Auditing is relevant to the audit when the Standard on Cost Auditing is in effect and the circumstances addressed by the Standard on Cost Auditing exist.
- The cost auditor shall have an understanding of the entire text of the Standard on Cost Auditing, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.
- The cost auditor shall not represent compliance with the Standards on Cost Auditing in the cost auditor's report unless the auditor has complied fully with all of the Standards on Cost Auditing relevant to the audit.
- In exceptional circumstances, the cost auditor may judge it necessary to depart from a relevant requirement in a Standard on Cost Auditing. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement.
- The cost auditor shall plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the Cost Statements to be materially misstated.
- The auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.
- The cost auditor shall exercise professional judgment in planning and performing the audit.
- The cost auditor shall determine whether the Cost Reporting Framework followed by management in preparing cost statements is in line with the Companies Act and the Rules prescribed there under.



- The cost auditor shall not be required to perform audit procedures regarding the entity's compliance with laws and regulations governing cost audit in the absence of identified or suspected non-compliance.
- If an objective in a relevant Standard on Cost Auditing cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the Standards on Cost Auditing, to modify the auditor's opinion.
- The Cost Auditor shall ensure adherence to the relevant clauses of the Guidance Manual for Audit Quality issued by Quality Review Board (QRB) constituted u/s 29A of The Cost and Works Accountants Act 1959.

Framework of the Standards on Cost Auditing

The framework of the Standards on Cost Auditing includes the following:

- **Preface**
- **GENERAL PRINCIPLES OF COST AUDIT**
 1. SCA-101, Agreeing the Terms of Cost Audit Engagements
 2. SCA-102, Knowledge of Business, its Processes and Business Environment
 3. SCA-103, Using the Work of Internal Auditor, External Auditor and Expert (other than Cost Auditor)
 4. SCA-104, Using the Work of another Cost Auditor
 5. SCA-105, Communication with Management
 6. SCA-106, Cost Audit Documentation
 7. SCA-107, Using the Technology, AI tools and Data Analytics in Cost Audit
 8. SCA-108, Conduct of Cost Audit in accordance with Laws, Regulations, Code of Ethics and Standards on Cost Auditing
- **COST AUDIT PROCESS**
 9. SCA-109, Planning Cost Audit
 10. SCA-110, Cost Audit Materiality
 11. SCA-111, Cost Audit Sampling
 12. SCA-112, Written Representations
 13. SCA-113, Cost Audit Procedures and Evidence
 14. SCA-114, Related Parties
 15. SCA-115, Corresponding Figures and Comparative Cost Statements
 16. SCA-116, Evaluation of Cost Audit Risks, Misstatements or Frauds



- **FORMATION OF OPINION AND REPORTING**

17. SCA-117, Forming an Opinion and Reporting on Cost Statements
18. SCA-118, Communicating Key Audit Observations and Suggestions

- **Glossary of Terms**

Structure of the Standards

The Standards on Cost Auditing consist of two parts; both have equal authority and application.

- Part-I covers the statement of requirements for the professional practice of cost auditing. These are set out in ***bold italic*** type.
- Part-II includes Application & Explanatory Material to the requirements. These paragraphs are set out in plain type.
- All terms used in the Standards on Cost Auditing have been defined and included in the Glossary appended at the end of Standards.

Standards Setting Process

Issue of Standard on Cost Auditing follows an extensive consultation process. First, exposure drafts of the Standards, including Introduction and Glossary, are prepared by the domain experts selected by the Cost Auditing and Assurance Standards Board (CAASB) of the Institute. These drafts are thoroughly discussed, clause-by-clause, in the CAASB. Finally, the exposure draft of these Standards is hosted on the Institute website and published in Management Accountant journal for comments of all stakeholders and public at large. Copies of exposure draft of these standards are also circulated to the concerned Government Authorities, Regulatory Bodies, Professional Institutes, Past Presidents, members of the Central & Regional Councils and all Chapters in India and professionals. Based on the comments received, the CAASB finalize the Standard on Cost Auditing for consideration by the Council of the Institute. After recommendation by the Council, the Standards are submitted to the Ministry of Corporate Affairs for the approval of the Central Government.

While formulating the Standards, the CAASB takes into consideration the applicable laws, rules, and regulations. However, if a particular Standard or any part thereof is inconsistent with a law, provisions of the law shall prevail.

Effective Date of Implementation

The Standards are effective for all cost audit engagements effective from the date of approval by the Central Government.



Requirements and Application & Explanatory Material

Category: General Principles of Cost Audit

SCA-101: Agreeing the Terms of Cost Audit Engagements

R.1 *Before accepting the cost audit engagement, the cost auditor shall ensure that the cost reporting framework to be applied in the preparation of the cost statements is acceptable; and obtain an agreement from the management that it acknowledges and understands its responsibility:*

- (a) For the 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;*
- (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 management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to error or fraud;*
- (e) To provide the Cost Auditor with:*
 - a. Access, at all times, to all information, including the books of accounts, vouchers, cost records, technical information, quantitative data, IT system, 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.*



R.2 The cost auditor shall agree to the terms of the cost audit engagement with management and the agreed terms shall be recorded in cost audit engagement letter or other suitable form of written agreement and shall include:

- (a) the objective and scope of the audit of 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.**

R.3 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.

R.4 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. However, if the terms of cost audit engagement are changed with reasonable justification, the cost auditor and management shall agree and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

R.5 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 owners or regulators.**

R.6 In case where the cost audit of the entity for the prior period was conducted by a different cost audit firm, the cost auditor shall communicate with the previous cost auditor as prescribed by the Institute.

R.7 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.



Application and Explanatory Material

- A.1 Cost audit engagement require satisfaction of certain preconditions that include consistent use by management of an acceptable cost reporting framework in the preparation of cost statements and the agreement of management to the premises on which a cost audit is conducted.
- A.2 Cost reporting framework means the framework adopted and applied consistently by the management in preparation of cost statements. It may be as required by law or regulation or that adopted for a particular purpose. It is designed to meet the cost information needs of either specific users or of a wide range of users. Further, it may be a fair presentation framework or a compliance framework.
- A.3 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. 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. Cost reporting framework ensures consistency in both the presentation of cost statements as well as in the performance of audit procedures.
- A.4 Presently, for the specified class of companies, the applicable cost reporting framework has been prescribed in the Companies (Cost Records and Audit) Rules 2014 notified under section 148 of the Companies Act 2013. Such cost reporting framework when applied gives true and fair view of the 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.
- A.5 Summing-up, 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.
- A.6 The applicable cost reporting framework identified in law or regulation is often based on the cost accounting standards issued by the Institute. 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 Notes issued by the Institute from time to time for determining the acceptability of cost reporting framework in such circumstances.
- A.7 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.
- A.8 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.
- A.9 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 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.

- A.10 Cost auditor should be independent and have free access to all the account books, cost records, cost data, & other relevant information of the entity. Hence, to ensure qualitative & effective cost audit, management must provide the cost auditor easy access to all such documents and records, including access to the entity's IT systems to verify the veracity of cost statements prepared by the management; effectiveness of its operational process & cost flow framework; reliability of its internal control systems in place; and averment of any risks of material misstatement or risk of fraud at the cost statement level. In addition, cost auditor should also be accorded access to all those persons in the entity who can provide requisite cost audit evidence.
- A.11 The roles of management in agreeing the terms of the cost audit engagement for the entity depend on its governance structure and relevant law or regulation. It is in the interests of both the entity and the cost auditor that the cost auditor is given 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. In these circumstances, the cost audit engagement letter may only refer to the relevant law or regulation and that management acknowledges and understands its responsibilities as set out in paragraph R.1. The cost auditor may nevertheless consider it appropriate to include the matters described in paragraph R.2 in an engagement letter for the information of management.
- A.12 The form and content of the cost audit engagement letter may vary for each entity. Information included in the cost audit engagement letter on the cost auditor's responsibilities may be based on Standard on Cost Auditing SCA-108, *Conduct of Cost Audit in accordance with Laws, Regulations, Code of Ethics and Standards on Cost Auditing*. A cost audit engagement letter may include the following. ***For reference, a model Engagement Letter is appended at the end of this document as Appendix-I.***
- i) Elaboration of the objectives and 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 and mode of communication of results of the cost audit engagement to the management and regulators, as agreed or as required by law or regulation.



- iii) The fact that because of the inherent limitations of cost audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the cost audit is properly planned and performed in accordance with standards on cost auditing.
 - iv) Arrangements regarding the planning and performance of the cost audit, including the composition of the engagement team.
 - v) The expectation that management will provide written representations.
 - vi) The fact that agreement of the management to make available to the cost auditor draft cost statements and any other relevant information in time to allow the cost auditor to complete the cost audit in accordance with the proposed timetable but within the stipulated time.
 - vii) The agreement of management to inform the cost auditor of facts that may affect the cost statements, of which management may become aware during the period from the date of the cost auditor's report to the date the cost statements are issued.
 - viii) The basis on which fees are computed and any billing arrangements.
 - ix) A request for management to acknowledge receipt of the cost audit engagement letter and to agree to the terms of the engagement outlined therein.
- A.13 If 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.
- A.14 In case of recurring cost audits, the cost auditor may decide not to prepare 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.
- A.15 A request from the entity for the cost auditor to change the terms of the cost audit engagement may result from a change in circumstances affecting the need for the service, a difference of opinion or misunderstanding as to the nature of cost audit as originally perceived or a restriction on the scope of the cost audit engagement, whether imposed by management or caused by other circumstances. The cost auditor may consider the justification given for the request, particularly the implications of a restriction on the scope of the cost audit engagement. If agreeable, the new terms of engagement must be suitably recorded by amending the existing engagement letter.
- A.16 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.
- A.17 If the cost auditor is unable to agree to the proposed change in terms and is not permitted by the management to continue the original audit engagement, the cost auditor is required to withdraw from the cost audit engagement where possible under applicable law or regulation and determine whether there is any obligation, either contractual or otherwise, to report the circumstances to the owners, or regulators.
- A.18 The cost auditor must communicate with the previous cost auditor of the entity if there is change of the cost auditor. For this purpose, the Institute has prescribed a format that is available in the Guidance Note on Cost Audit issued by the Institute. Further, the cost auditor may also have consultations with the previous cost auditor review the previous year's cost audit working papers, and previous year's significant transactions having an impact on the current year's cost. For better understanding, the cost auditor may need to expand the planning activities to first understand the entity.
- A.19 If the preconditions for an audit/professional assignment are not present, the cost auditor shall discuss the matter with management. Unless required by law



or regulation to do so, the cost auditor shall not accept the proposed cost audit engagement if the cost auditor assesses that the cost reporting framework to be applied in the preparation of the cost is unacceptable or if the cost audit engagement agreement has not been concluded.

SCA-102, Knowledge of Business, its Processes, and the Business Environment

R.8 The cost auditor shall have adequate understanding and knowledge of the following with a view to develop reasonable assurance on the cost statements on which he is expressing an opinion.

- (a) The nature of the entity, its size, ownership and governance structure, management & organisational structure, marketing & distribution set-up, etc.;**
- (b) The nature of activities, business processes, major inputs, outsourcing, joint & by-products, wastages and major outputs etc.;**
- (c) Key personnel in all departments including in Finance, Accounts, Costing, IT, Administration, Production, Purchase, Sales, etc;**
- (d) Relevant industry, regulatory, and other external factors including the applicable cost and financial reporting framework;**
- (e) The entity's selection and application of financial accounting policies, cost accounting policies, purchase policy, sales policy, etc.;**
- (f) Related parties and nature of transactions with them;**
- (g) Inventory receipt, storage, issue & valuing policies; physical verification system; and inventory management system;**
- (h) Cost/Management Information System, including measurement and review of the entity's performance;**
- (i) The entity's internal control systems including those relevant to the cost audit and reporting;**
- (j) Whistle blower policy and code of ethics for Directors maintained by the management to cultivate a culture of honesty and ethical behaviour;**
- (k) The entity's risk identification system, assessment process, and management policy for cost computation and reporting, risk of**



material misstatement or risk of fraud at the cost statement level, assertion level or in relation to transactions with related parties;

- (l) the scope, coverage, adequacy and effectiveness of the internal audit function, especially in relation to cost records; and***
- (m) IT architecture, systems and programmes in use, IT policy, authorization checks, controls on data access & for changes therein; and security of data.***

Application and Explanatory Material

A.20 Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous and dynamic process of gathering, updating, and analysing information throughout the cost audit. The understanding establishes a frame of reference within which the cost auditor plans the cost audit and exercises professional judgment throughout the cost audit. The cost auditor should refer to all possible resources and materials to gather knowledge about the entity and its environment and should have documentary evidence in his possession to support that he has fully understood the entity and its environment. Some ways to get the general information about the entity:

- i) Annual Report of the entity
- ii) Process Study
- iii) Plant Visits
- iv) Supply Chain framework
- v) Company's website
- vi) Discussion with management and HODs to have a basic understanding of the business, & strategies as well as operational aspects.
- vii) Annual Report of Competitor/s
- viii) Information available on the Internet
- ix) Newspapers / Journals
- x) Relevant Ministerial reports
- xi) Reports of Centre for Monitoring Indian Economy (CMIE)
- xii) Research Papers published etc.

A.21 Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments etc. Examples of matters that the cost auditor may consider include:

- (a) The market and competition



- (b) Cyclical or seasonal activity
 - (c) Changes in product technology
 - (d) Business risk (for example, high technology, high fashion, ease of entry for competition)
 - (e) Declining or expanding operations
 - (f) Adverse conditions (for example, declining demand, excess capacity, serious price competition)
 - (g) Key ratios and operating statistics
 - (h) Specific cost accounting practices and problems
 - (i) Specific or unique practices (for example, relating to labour contracts, financing methods, accounting methods).
 - (j) Energy supply sources and cost
 - (k) Environmental requirements and problems
- A.22 An understanding of the entity's selection and application of cost accounting policies may encompass matters such as:
- (a) The methods the entity uses to account for significant and unusual transactions (abnormal events).
 - (b) The effect of significant cost accounting policies in controversial or emerging areas for which there is lack of authoritative guidance or consensus.
 - (c) Changes in the entity's cost accounting policies.
 - (d) Cost reporting framework, and laws and regulations that are new to the entity and when and how the entity will adopt such requirements.
- A.23 Related parties, by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management. Cost auditor is responsible for maintaining alertness for related-party information when reviewing records or documents during the cost audit. This includes the inspection of certain key documents. Hence, relevant related party information may be gathered by the cost auditor, for example:
- a) The identity of the entity's related parties;
 - b) The nature of the related party relationships and transactions; and
 - c) Significant or complex related party relationships or transactions that may require special audit consideration, in particular transactions in which management is involved.
- A.24 Continued pressure of better performance may motivate management to either take action to improve the business performance or to misstate the cost or financial statements. Accordingly, an understanding of the entity's performance



measures assists the cost auditor in considering whether pressures to achieve performance targets may result in management actions that increase the risks of material misstatement, including those due to fraud. Accordingly, the cost auditor may consider reviewing the following parameters:

- (a) Key performance indicators and key ratios (financial and non-financial).
- (b) Key trends and operating statistics.
- (c) Period-on-period cost performance analyses, including cost of production/ operations, cost of sales, margin and key cost element-wise variance analyses for each product or service produced by the entity.
- (d) Business process flow analysis; operating cycle analysis; capacity utilization analysis; productivity efficiency analysis; benchmarking analysis; and energy/utilities efficiency analysis.
- (e) Working capital & inventory management analysis.
- (f) Employee performance measures and incentive compensation policies.
- (g) Comparisons of an entity's performance with that of competitors.

A.25 While understanding controls that are relevant to the cost audit, the cost auditor should evaluate the design of those controls and determine whether they have been implemented properly, by performing procedures in addition to discussions with the entity's personnel. The cost auditor should obtain an understanding of control activities relevant to cost/ management information system in order to assess the risks of material misstatement at the assertion level and design further cost audit procedures responsive to assessed risks. In addition, the cost auditor should obtain an understanding of the major activities that the entity uses to monitor internal control relevant to cost reporting, including those related to those control activities relevant to the cost audit, and how the entity initiates remedial actions to deficiencies in its controls.

A.26 Companies Act, 2013 and SEBI (LODR) Regulations, 2015 provide that the Board of Directors of all listed and specified non-listed companies shall lay down a code of conduct for all members of board of directors and senior management and such code of conduct shall suitably incorporate the duties of independent directors as laid down in the Companies Act, 2013. In addition, section 177(9) of the Companies Act 2013 read with Rule 7 "Establishment of Vigil Mechanism" of the Companies (Meetings of Board and its Powers) Rules, 2014 provide that all such companies shall establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances. Accordingly, cost auditor may understand whether the management has such policies in place and a culture of honesty and ethical behaviour has been cultivated across the entity.



- A.27 Cost auditor should obtain an understanding of risk assessment process of the entity and the results thereof. If the cost auditor identifies risks of material misstatement that management failed to identify, the cost auditor should evaluate whether there is a significant deficiency in internal control with regard to the entity's risk assessment process. As part of the risk assessment, the cost auditor should also determine whether any of the risks identified is, in the cost auditor's judgment, a significant risk.
- A.28 If an entity has an internal audit function, inquiries of the appropriate individuals within the function may provide information that is useful to the cost auditor in obtaining an understanding of the entity and its environment, and in identifying the scope, coverage, adequacy, and effectiveness of the internal audit function, especially in relation to cost records and whether the internal audit function has appropriate quality control policies and procedures. If based on responses to the cost auditor's inquiries, it appears that there are findings that may be relevant to the entity's cost audit; the cost auditor may consider it appropriate to read related reports of the internal audit function.
- A.29 The cost auditor should assess the following with regard to the entity's IT environment and controls.
- i) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
 - ii) Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
 - iii) The possibility of IT personnel gaining access to privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
 - iv) Unauthorized changes to data in master files.
 - v) Unauthorized changes to systems or programs.
 - vi) Failure to make necessary changes to systems or programs.
 - vii) Inappropriate manual interventions.
 - viii) Potential loss of data or inability to access data as required.



SCA -103, Using the Work of Internal Auditor, & External Auditors and Experts (other than Cost Auditor)

R.9 The cost auditor may plan to use the work performed by internal auditor or external auditors in areas that are found relevant & adequate to his overall audit strategy and audit plan and is also found relevant to make his audit opinion.

R.10 If expertise in a field other than cost accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the cost auditor shall determine whether to use the work done by an expert who has the necessary competence and capabilities in that field.

R.11 The cost auditor shall communicate with the management whether he has planned to use the work of internal audit, external audit, or experts.

R.12 Before using, the cost auditor shall evaluate the adequacy of the expert's work, including the relevance and reasonableness of the expert's assumptions, methods, findings, or conclusions.

R.13 Using the work of internal audit, external audit or experts shall not reduce the cost auditors' involvement and responsibility for his audit opinion.

R.14 The cost auditor shall refer to the work of internal auditor or external auditors or experts in his report, wherever he has relied thereupon.

Application and Explanatory Material

A.30 The cost auditor exercises professional judgment in determining whether the work of the internal auditor, external auditor or an expert can be used for purposes of the cost audit, and the nature and extent to which the work of the internal auditor, external auditor or expert can be used in the given circumstances.

A.31 Expertise in a field other than accounting or auditing may include expertise in relation to such matters as:

- i) Determination of installed/ achievable capacity of plant, machineries, process, product etc.
- ii) Determination and or verification of consumption norms of various inputs like material, labour, machine hours, technical standards etc.
- iii) Impact on consumption norms of various inputs due to change in production process, change in technology, or substitute of major input material(s) etc.



- iv) Efficiency of machines, boiler etc. which has significant impact on determination of machine hour rate, labour hour rate and or utilities consumption pattern; or
 - v) The interpretation of contracts, laws and regulations.
- A.32 The cost auditor is required to communicate with the management an overview of the planned scope and timing of the cost audit. Use of the work of internal audit function is normally an integral part of the cost auditor's overall audit strategy and is therefore relevant to the management for its understanding of the proposed cost audit approach. Further, as part of his planned strategy, the cost auditor should also decide and communicate with the management of likelihood of using the work of external auditors or experts in selected areas.
- A.33 Application of a systematic and disciplined approach to planning, performing, supervising, reviewing, and documenting its activities distinguishes the internal auditor function from other monitoring & control activities. Therefore, the cost auditor may plan to use the work of internal audit function for purposes of the cost audit and consider whether the planned nature and scope of the work of the internal audit function that has been performed, or planned to be performed, is relevant to the overall cost audit strategy and cost audit plan. Examples of work of the internal audit function that can be used by the cost auditor include the following:
- i) Testing of the operating effectiveness of controls;
 - ii) Substantive procedures involving limited judgment;
 - iii) Tracing transactions relevant to cost reporting; and
 - iv) Testing of compliance with regulatory requirements.
- A.34 Wherever needed, the cost auditor may use the work of an external expert who is generally not a member of the audit team unless otherwise required by law or regulation. He may therefore be subject to same level of ethical and other professional requirements, including those relating to independence. The cost auditor should keep record of the use of the work of an external expert.
- A.35 The competence, capabilities and objectivity of a cost auditor's expert are factors that significantly affect whether the work of the expert will be adequate for the cost auditor. Competence relates to the nature and level of expertise of the cost auditor's expert. Capability relates to the ability of the cost auditor's expert to exercise that competence in the circumstances of the engagement. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the expert's professional or business judgment.



- A.36 Information regarding the competence, capabilities and objectivity of a cost auditor's expert may come from a variety of sources, such as:
- i) Personal experience with previous work of that expert.
 - ii) Discussions with that expert.
 - iii) Discussions with other auditors or others who are familiar with that expert's work.
 - iv) Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
 - v) Published papers or books written by that expert.
 - vi) The cost auditor's firm's quality control policies and procedures.
- A.37 In areas other than accounting & auditing, cost auditor is entitled to rely on the entity's control systems and the work done by internal/other external auditors as also that done by the experts. The extent of reliance will vary with the circumstances, and may affect the nature, timing, and extent of the cost auditor's procedures. However, such reliance does not reduce the cost auditor's responsibility to meet the requirements of the Standards on Cost Auditing.
- A.38 In some cases, law or regulation may require a reference to the work of internal or external auditors or of the expert in the cost auditor's report. However, for the purposes of transparency & good governance, it may be appropriate in some circumstances to refer to the reliance made on the work done by internal/external auditors or expert in cost auditor's report expressly; especially if report is containing a qualified opinion, to explain the nature of the qualification. In such circumstances, the cost auditor may need the consent of the internal/external auditors or the cost auditor's expert before making such a reference.

SCA-104, Using the Work of other Cost Auditor(s)

R.15 The lead cost auditor shall evaluate whether all units, products, services, and operations of the entity, as prescribed by law or regulation, have been considered and appropriately included in its consolidated cost statements.

R.16 The lead cost auditor shall apply audit procedures to ensure that the cost and other statements of each unit, product, or operations under cost audit and audited by other cost auditor(s) are based on the applicable cost reporting framework.



R.17 The lead cost auditor shall consider the findings of other cost auditor(s) and consolidate their observations or suggestions or qualifications and reproduce the same in the cost audit report.

R.18 The lead cost auditor shall base his opinion on the cost statements of the entity as a whole relying upon the cost statements and reports of all other cost auditors alongwith the cost statements and reports of the units or products audited by him.

Application and Explanatory Material

- A.39 The lead cost auditor shall obtain an understanding of all the components of the entity, its control and consolidation process. Component here means a factory, unit, branch, product, or service for which the management prepares cost statements that should be included in the consolidated cost statements of the entity. The lead cost auditor shall evaluate & ensure that all components of the entity, as prescribed by law or regulation, for which consolidation is being done by the lead cost auditor have been considered and appropriately included in its consolidated cost statements.
- A.40 If the cost statements of a component have not been prepared in accordance with the applicable cost reporting framework and cost accounting standards, the lead cost auditor shall communicate with the other cost auditor to ascertain the reasons in this regard together with the impact of such deviation on the component cost statements and also on the consolidated cost statements. Lead cost auditor shall evaluate whether the costing information of that component has been appropriately presented in the consolidated cost statements of the entity.
- A.41 The lead cost auditor shall consolidate the cost statements audited by the other cost auditors. The lead cost auditor shall consider the findings of other cost auditor(s) and consolidate the observations or suggestions or qualifications of other cost auditor(s) and reproduce the same in the consolidated cost audit report of the lead cost auditor. Depending on the circumstances of the engagement, the cost statements of the components may be aggregated at various levels for purposes of the procedures like identification of abnormal fluctuations, risks of material misstatement, etc.
- A.42 The lead cost auditor may consider it appropriate to discuss with the other cost auditor(s) and the management, the audit findings or other matters affecting the cost statements of the components. For example, in case of goods or service are rendered by one component of the entity to another component (inter-unit transfers) at market price or at price which include margins, particularly in those



entities which consider their components as profit centres, adjustments for them are required during consolidation of cost statements.

- A.43 The lead cost auditor may be the cost auditor of one or more components of the entity. Therefore, while preparing his opinion on the consolidated cost statements, the lead cost auditor must rely on the cost statements and reports/findings & opinions of all other cost auditors alongwith the cost statements and reports/findings for the components audited by the lead cost auditor.

SCA-105, Communication with Management

R.19 The cost auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate. If the cost auditor communicates with a subgroup of the governing body, for example, an audit committee, or an individual, the cost auditor shall determine whether the cost auditor also needs to communicate with the governing body.

R.20 The cost auditor shall communicate the following:

- (a) Responsibilities of the cost auditor in relation to audit of cost statements, including that the audit of cost statements does not relieve management of their responsibilities;***
- (b) The cost auditor's audit plan and audit strategy;***
- (c) Written representations, the cost auditor is requesting;***
- (d) The cost auditor's views about significant qualitative aspects of the entity's cost accounting practices including cost accounting policies, cost statements and related disclosures;***
- (e) Significant difficulties, if any, encountered during the cost audit;***
- (f) Significant matters, if any, arising from the cost audit;***
- (g) Deficiencies in internal controls, if any, identified during the cost audit giving description of the deficiencies and an explanation of their potential effects;***
- (h) Significant findings, observations and suggestions, if any, from the cost audit;***
- (i) A statement that the audit team and others in the firm have complied with relevant ethical requirements;***



(j) Details of an offence of fraud involving such amount or amounts as prescribed by law or regulation, that is being or has been committed in the entity by its officers or employees that has come to the Cost Auditor's knowledge during the course of performing his duties as cost auditor; and

(k) Any other matter(s) as may be prescribed by the law or regulation.

Application and Explanatory Material

A.44 In India, provisions contained in the Companies Act, 2013, and Regulations issued by various Regulatory bodies like Reserve Bank of India (RBI), Securities & Exchange Board of India (SEBI), etc. has laid well defined governance structure in listed and non-listed entities. It contains duties, powers, and responsibilities of the Board of Directors, Independent Directors, Board Committees such as Audit Committee, CSR Committee, etc. and senior management that includes the entity's chief executive officer, chief financial officer (or equivalent) and other functional heads.

A.45 Keeping in view the respective role and responsibility of the Board of Directors, Board Committee(s) and management, the cost auditor may discuss and decide effective communication structure to be adopted for the entity. The cost auditor, in consultation with the management, should determine communication levels, persons, and authorities. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated. As far as practicable, it should be either made part of the cost audit engagement document or communicated through the management representation.

A.46 The cost auditor may discuss certain matters only with appropriate level of management unless it is inappropriate to do so in the circumstances. The appropriate level of management is the one that has responsibility and authority to evaluate the deficiencies and to take the necessary remedial action(s). For significant deficiencies, the appropriate level is likely to be the chief executive officer or chief financial officer (or equivalent). For other deficiencies, the appropriate level may be operational management who have more direct involvement in the relevant areas affected.

A.47 When considering communicating with a subgroup of the management, the cost auditor may take into account such matters as:

- i) The respective responsibilities of the subgroup.
- ii) The nature of the matter to be communicated.
- iii) Relevant legal or regulatory requirements.



- iv) Whether the subgroup has the authority to take action in relation to the information communicated and can provide further information and explanations the cost auditor may need.
- A.48 Audit committees (or similar subgroups with different names) exist in many governance structures. Although their specific authority and functions may differ, communication with the audit committee, where one exists, has become a key element in the cost auditor's communication with the management. Good governance principles suggest that:
- i) The cost auditor should be invited to regularly attend meetings of the audit committee.
 - ii) The chairperson & other members of the audit committee should liaise with the cost auditor periodically.
 - iii) The audit committee must meet the cost auditor without management present at least annually.
- A.49 The cost auditor's responsibilities in relation to audit of the cost statements are often included in the audit engagement letter or other suitable form of written agreement that records the agreed terms of the cost audit engagement. Providing a copy of that engagement letter or other suitable form of written agreement to the management may be an appropriate way to communicate with them regarding the cost auditor's responsibility for performing the audit in accordance with standards on cost auditing and expression of an opinion on the cost statements. The cost auditor's responsibility for communicating particular matters may be as required by law or regulation, or by agreement with the entity or by additional requirements applicable to the cost audit engagement (for example, as per Cost Accounting Standards issued by the Institute).
- A.50 Communication regarding the planned scope and timing of the cost audit may assist the management to understand better the effect & consequences of the cost auditor's work, to discuss issues of risk and the concept of materiality with the cost auditor, and to identify any areas in which they may request the cost auditor to undertake additional procedures. It may also help the cost auditor to understand better the entity and its environment.
- A.51 Cost reporting framework allows the entity to make cost accounting policies and cost statement disclosures. Open and constructive communication about significant qualitative aspects of the entity's cost accounting policies and practices may include comment on the acceptability of significant cost accounting policies and practices.



- A.52 Significant matters require discussion or communication with the management. These may include matters such as whether the cost statements are prepared in accordance with the applicable cost reporting framework and cost accounting standards and are free from material misstatement, whether due to fraud or error and give a true and fair view; cost accounting policies selected and applied are consistent, reasonable, and appropriate; and information presented in the cost statements is relevant, reliable, comparable, and understandable, etc.
- A.53 Significant difficulties encountered during the cost audit may include matters such as significant delays in providing cost records, cost data, cost statements & other required information by the management; cost auditor being given unnecessarily short time within which to complete the cost audit; extensive unexpected effort required to obtain sufficient appropriate audit evidence; unavailability of expected information; restrictions imposed on the cost auditor by management etc. Cost auditor may also need to communicate significant difficulties with the audit committee or board of directors or even with the regulators, as required by law or regulation.
- A.54 If the cost auditor identifies deficiencies in internal controls designed to prevent or detect fraud during the audit of cost statements, the cost auditor should take into account those deficiencies when developing the response to risks of material misstatement. Further the cost auditor would also need to consider the requirements of other guidance issued by the Institute for the procedures to be performed in connection with verification of deficiencies in internal controls.
- A.55 The cost auditor must evaluate the severity of each control deficiency that comes to his attention to determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses as of the cost reporting date. In planning and performing the cost audit, however, the cost auditor is not required to search for deficiencies that, individually or in combination, are less severe than a significant deficiency.
- A.56 Communicating significant deficiencies in writing to the management reflects the importance of these matters and assists the management in fulfilling their oversight responsibilities.

SCA-106, Cost Audit Documentation

R.21 The cost auditor shall keep records and documents in respect of the following, as may be appropriate and made available by the entity:

- (a) Key understanding of the entity, its structure & regulatory environment, related parties, business process, production details,***



internal control systems, financial & cost reporting framework, risk management policy, IT policy, etc.

- (b) The overall audit strategy, the audit plan and any significant changes made therein during the audit engagements and the reasons for the changes.***
- (c) The audit procedures performed, including new/additional procedures performed, relevant audit evidence obtained, and the conclusions reached, including characteristics of the specific items or matters tested, the persons responsible for performing and reviewing such procedures with relevant dates and extent of review.***
- (d) Discussions of significant matters with client personnel, third parties, outsiders, and among the audit team members.***
- (e) Any departure from the requirement in Standards on Cost Auditing, alongwith reasons & justification of such departures.***

R.22 The cost auditor's records & documents should enable any other competent person not connected with the said audit, including the peer reviewer to understand:

- (a) Conformance of audit procedures performed with legal and regulatory requirements; and also with the Standards on Cost Auditing;***
- (b) The results of audit procedures performed and the audit evidence obtained;***
- (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.***

R.23 The cost auditor shall prepare audit documentation on a timely basis and assemble it in an audit file.

Application and Explanatory Material

A.57 Preparing sufficient and appropriate cost audit documentation facilitates evaluation of the cost audit evidence obtained and conclusions reached before the cost auditor's report is finalised. The form, content and extent of cost audit documentation depend on factors such as the size and complexity of the entity, nature of cost audit procedures performed, identified risks of material



misstatements, cost audit evidence obtained, etc. Further, cost audit documentation may be recorded on paper or on electronic or other media.

- A.58 Cost audit documentation will usually contain all documents, data and information obtained to understand the entity, check lists of activities, cost audit plan & program, cost audit query list, abstracts of significant contracts relating to costs and revenues, letters of confirmation, letters of representation from management, correspondence concerning significant matters and abstract or copies of the entity's records. It also includes correspondence with the regulators, before or after submission of cost auditor's report.
- A.59 Cost audit documentation must contain evidence of conformance to requirements of law, regulations, and standards on cost auditing such as an adequately documented audit plan, signed engagement letter from the auditee, records of discussions with the client personnel, etc. Records of discussions include minutes of discussion of significant matters with management and others including discussion with third parties seeking information or confirmation.
- A.60 Facts which become known to the cost auditor after the date of the audit report but which if known earlier would have caused the cost statements to be changed or the cost audit report to be modified should be added to the cost audit documentation. The resulting changes to the audit documentation must also be reviewed as the original documentation.
- A.61 The requirements of the standards on cost auditing are designed to enable the cost auditor to achieve the objectives specified in the standards and overall objectives of the cost audit. Therefore, it is mandatory to comply with the standards on cost auditing that is relevant in the circumstances of the cost audit. Cost auditor must document all such requirements that are relevant in the circumstances. However, in exceptional circumstances, the cost auditor may find it necessary to depart from the requirements of the standards on cost auditing and perform alternative audit procedures different from a corresponding requirement in a standard on cost auditing. The cost auditor must document the alternate cost audit procedures performed to achieve the aim of that requirement, and the reasons for the departure.
- A.62 Matters that give rise to significant risks of a material misstatement are significant matters including those causing a revision of the cost auditor's previous assessment of the risks of material misstatement. For example, cost auditor may have reached a certain conclusion regarding material cost in a cost statement based on the BOM but his assessment may undergo a change if he finds that there is considerable use of substitute and alternate materials in the



actual production process. Similarly, matters that cause the cost auditor significant difficulty in applying necessary audit procedures are also significant. For example, heaps of bulk material in irregular shapes which make volumetric measurement of stock in a physical stock unreliable.

- A.63 Determining the significant matters in cost audit to warrant their inclusion in the documentation must be objectively done. The conclusions reached and the application of professional judgment in respect of these also needs to be documented. For example, determination of normal capacity for distribution of overheads is a significant matter in cost audit and requires not mere calculations but considerable judgment. These should be adequately documented.
- A.64 Preparation of audit documentation on timely basis helps to enhance the quality of audit. For example, audit documentation prepared during the execution of cost audit procedures is more important rather than after the execution. Hence, cost audit documentation must be assembled as the audit goes on. Assembling the final audit file should be completed within a reasonable time after the completion of the audit.
- A.65 Cost auditor should not delete or discard audit documentation of any nature from the audit file, including his working sheets, before the end of its retention period. Further, the cost audit documentation is the property of the cost auditor, unless otherwise specified by law or regulation. Cost auditor may at his discretion share all or part of cost audit documentation with the client. Cost auditor shall produce cost audit documentation before the regulators or judicial authorities, if so required.

SCA-107, Using the Technology, AI Tools, and Data Analytic in Cost Audit

R.24 The cost auditor shall consider the IT environment in designing audit procedures to review the cost accounting & control systems, cost flow processes, operational analysis, and risk management framework of the entity. Accordingly, the cost auditor shall consider the effect of technology on cost audit engagement, including its use in data analysis.

R.25 The cost auditor shall ascertain whether the information technology system in the entity ensures accuracy and authenticity of cost data and information processed.

R.26 The cost auditor shall use technology to aid professional scepticism, and lack of bias that allows him to choose appropriate audit samples, test large and complex data sets, perform analytical procedures, present the findings graphically, and perform a risk assessment based on the entire population.



R.27 By applying data analytic procedures, the cost auditor shall ascertain accurate frequency and flow of cost data to different activities, cost centres, and cost objects.

R.28 The cost auditors must learn the interplay of major technology led disruptions caused by Robotic Process Automation, Artificial Intelligence (AI), Data Analytics, and Machine Learning, etc. and monitor their impact on the business processes and risk management. The cost auditor and his team must acquire adequate skills in handling the AI tool as their sound professional skepticism would boost the interaction between AI tools and audit process.

R.29 The cost auditor should have sufficient knowledge of the information technology systems to plan, direct, supervise, control, and review the work performed. The cost auditor shall assess their data analytical capabilities, strengths, and weaknesses. If specialized skills are needed, the cost auditor should seek the assistance of a technical expert possessing such skills, who may either be the cost auditor's staff or an outside professional.

Application and Explanatory Material

- A.66 In today's business environment, their IT based information systems use state-of-the-art technology to capture, classify, summarize, and report data in a meaningful manner to all users. It includes an enterprise resource planning (ERP) system. The use of IT changes the processing, storage, retrieval and communication of financial & non-financial information and the interplay of processes, systems, and control procedures.
- A.67 The cost auditor shall obtain an understanding of the technology-based operational systems, processes, control environment, risk-response activities, and internal control systems sufficient to plan the cost audit and to determine the nature, timing, and extent of the cost audit procedures. Such an understanding would help the cost auditor to develop an effective cost audit approach. In addition, adequate knowledge of the information technology tools & techniques would be of extreme significance and usage to plan, direct, supervise, control, and review the work performed by the cost auditor's team.
- A.68 Information Technology systems can generate such data that might be useful to the cost auditor to perform substantive tests and analytical procedures. The potential for use of computer-assisted cost audit techniques or cost data analysis would assist in enhancing efficiency in the performance of cost audit procedures and enable the cost auditor to apply these procedures more effectively & efficiently to the entire population of transactions.



- A.69 Application of technology-based data analytical procedures to test and analyse large and complicated data assist the cost auditor to identify cases of material misstatements in the cost statements, if any, at the assertion level or otherwise, arising due to error or fraud. The cost auditor shall also check whether the IT framework & output modules used by the entity ensures accurate flow of cost data to various cost centres and cost objects and whether it timely generates correct, and complete information needed to prepare cost statements for each product or service.
- A.70 Data Analytics enable analysing the cost data in a structured manner and making decisions based on it. It also helps in early detection of risks in the cost audit process and to identify the frauds or areas where internal controls are missing. Therefore, cost auditor should effectively use data analytics in all the three stages of cost audit viz. planning, execution, and reporting.
- A.71 As a result of the review, if the cost auditor is not able to rely on the effectiveness of IT environment, he may perform such substantive testing or test of IT controls, as deemed fit in the circumstances. The cost auditor should apply his professional judgment and skill in reviewing the IT environment and assessing the interfaces of such IT infrastructure with other business processes. If necessary, the cost auditor may take assistance of an IT expert, who is either an employee of the entity or an outside expert.
- A.72 For conducting cost audit under an IT and Technology driven environment, the cost auditor and his team should possess requisite knowledge of latest IT and Data Analytic tools. The cost auditor shall have or obtain such skills, competence, & technical knowledge as is necessary for the purpose of discharging his responsibilities. Such skills may be obtained as part of knowledge update programs and skill-upgrade training workshops organized by the professional Institutes in the country.
- A.73 The cost auditor shall obtain technical advice and assistance from competent experts if the cost auditor and his team does not possess the necessary knowledge, skills, expertise, or experience needed to perform all or part of the cost audit engagement using the relevant technical tools & applications. Cost auditor may seek the assistance and place reliance on the work of an expert, may be in a complex area or field or in a unique and specialised technical discipline. Such an expert(s) may be part of the cost auditor's team, or an employee of the entity, or even an outside professional.



SCA-108, Conduct of Cost Audit in accordance with Laws, Regulations, Code of Ethics and Standards on Cost Auditing

R.30 The cost auditor shall plan and perform cost audit with professional judgment and skepticism. While conducting cost audit, he shall comply with:

- (a) the laws and regulations applicable to the audit of cost statements;***
- (b) the relevant ethical requirements including those pertaining to independence in respect of cost audit engagements; and***
- (c) each of the Standards on Cost Auditing relevant to the audit.***

R.31 The cost auditor shall have complete understanding of the Standards, including its application and other explanatory material, so as to understand and apply its requirements properly.

R.32 In exceptional circumstances, the cost auditor may judge it necessary to depart from a relevant requirement in a Standard on Cost Auditing. In such circumstances, he shall modify his audit opinion duly explaining the departures with reasons.

R.33 The cost auditor shall obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry or sector in which it operates; and how the entity is complying with that framework.

R.34 The cost auditor shall take up with management to share all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects have been considered while preparing the cost statements.

R.35 The cost auditor shall determine whether the cost reporting framework followed by the management in preparing cost statements is in line with the applicable law or regulations. In case of identified or suspected non-compliance that has a material effect and not adequately reflected in the cost statements, the cost auditor shall express qualified or adverse opinion.

R.36 If the cost auditor has identified or suspected non-compliance with laws and regulations, he shall determine whether he has a responsibility to report the identified or suspected non-compliance to parties outside the entity, say regulators.

Application and Explanatory Material

A.74 An attitude of professional skepticism means the cost auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained



and reliability of documents and responses to queries and other information obtained from management. An attitude of professional skepticism is necessary throughout the cost audit process for the cost auditor to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions from cost audit observations, and of using faulty assumptions in determining the nature, timing and extent of the cost audit procedures and evaluating the results thereof. Due to these factors, it can be said that cost audit is not a guarantee that the cost statements are free from material misstatement because absolute assurance is not attainable. Further, cost audit opinion does not assure future viability of the entity or continuity of its various products/services and nor it certifies efficiency or effectiveness of the management in conducting affairs of the entity.

- A.75 The requirements of cost reporting framework determine the form and content of cost statements and what constitutes a complete set thereof. In performing cost audit, the cost auditor is required to comply with legal or regulatory requirements as well as with the standards on cost auditing. In such cases, the cost auditor may be required to perform additional audit procedures to ensure compliance with the legal or regulatory requirements and standards on cost auditing. As already notified by the Institute, standards on cost auditing do not override law or regulations that govern cost audit process.
- A.76 Cost auditor should comply with relevant ethical requirements as per Code of Ethics issued by the Institute of Cost Accountants of India. This code establishes fundamental principles of professional ethics relevant to the cost auditor while conducting cost audit and provides a conceptual framework for applying these principles. The fundamental principles with which the cost auditor is required to comply are Independence, Integrity, Objectivity, Professional competence and due care, Confidentiality and Professional conduct. Cost auditor's independence from the entity safeguards the cost auditor's ability to form an opinion without being affected by influences that might compromise that opinion.
- A.77 Cost auditor shall comply with each of the standards on cost auditing to the extent these are relevant to the cost audit. Standards on cost auditing are essential to ensure quality, efficiency, and effectiveness of cost audit. These are means to evaluate whether the cost auditor has fulfilled his professional responsibilities to the satisfaction of all stakeholders. Standards guide how cost auditor should conduct professional engagements; how to improve the quality of cost audit & reporting; and how to train his team. These standards deal with general responsibilities of the cost auditor and have the effect of dictating cost auditors' activities and behaviour. Standards on cost auditing also provide a



benchmark that facilitates the calibration of a cost auditor's legal liability in the event of substandard audit.

- A.78 To carry out the cost audit successfully, the cost auditor must have complete understanding of the standards on cost auditing, their application and relevant explanatory material issued by the Institute of Cost Accountants of India. Cost auditor should update himself with the latest developments with regard to these standards by attending relevant programs, events, workshops, etc. organised by the Institute so as to understand and apply its requirements properly.
- A.79 The need for the cost auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and in the specific circumstances of the cost audit wherein that procedure would be ineffective in achieving the aim of the requirement. Wherever such exceptional circumstances exist, and the cost auditor is required to depart from a relevant requirement in a standard on cost auditing, he must record reasons of such departure.
- A.80 Cost auditor should obtain a general understanding of the legal and regulatory framework within which the entity operates, and how the entity complies with that framework. The cost auditor should understand of those laws and regulations that directly determine the reported amounts and disclosures in the cost statements; and inquire of management concerning the entity's policies and procedures regarding compliance with such laws and regulations.
- A.81 Because the effect on cost statements of laws and regulations can vary considerably, written representations provide necessary audit evidence about management's knowledge of identified or suspected non-compliance with laws and regulations, whose effects may have a material effect on the cost statements. If the cost auditor suspects there may be non-compliance, the cost auditor shall discuss the matter with management. If management does not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the cost auditor's judgment, the effect of the suspected non-compliance may be material to the cost statements, the cost auditor may consider expressing qualified or adverse opinion.
- A.82 The cost auditor's professional duty to maintain confidentiality of the client information may preclude reporting identified or suspected non-compliance with laws and regulations to a party outside the entity. However, the cost auditor's legal responsibilities may vary, and, in certain circumstances, the duty of confidentiality may be overridden by the statute, the law or the courts of law. Accordingly, the cost auditor may consider it appropriate to comply with his



legal responsibilities and report on instances of non-compliance to the designated parties or regulators.

Category: Cost Audit Process

SCA-109, Planning Cost Audit

R.37 Prior to entering the planning phase, the cost auditor shall ensure that:

- (a) his appointment as cost auditor is proper, he has received the letter of appointment and legal formalities regarding his appointment have been complied with; and***
- (b) an understanding of the terms of reference including the units to be covered, products/services to be audited, etc. has been agreed between him and the auditee.***

R.38 Based on the relevant factors, the cost auditor shall formulate an overall audit strategy and audit plan that sets the scope, timing and direction of the audit and the audit procedures. The overall audit strategy and audit plan shall be updated as required during the course of audit.

Application and Explanatory Material

A.83 Prior to planning the cost audit, the cost auditor shall ensure that:

- i) His appointment related all formalities have been complied with.**
- ii) The objectives and scope of cost audit to be audited have been agreed to.**
- iii) Responsibilities of the cost auditor; and that of the management have been discussed and well documented.**
- iv) The applicable cost reporting framework for the preparation of the cost statements, with reference to the industry, has been identified as required by law or regulation.**
- v) He has the knowledge about the size and complexity of the entity's activities, units to be visited, the number of products/services to be covered, the processes and operations involved, the audit team members' previous experience with the entity & industry and changes in circumstances that occur during the cost audit.**
- vi) After the cost auditor has accepted the appointment for an entity, there are no changes in his position in relation to the entity that impede his arm's length relationship with the entity. Such as, acceptance of an**



assignment relating to designing and implementation of cost accounting system for the entity.

- vii) After his acceptance of the assignment, no issues have cropped up that may affect the cost auditor's willingness to continue the engagement.

A.84 Planning cost audit is not a discrete phase, but rather a continuous and iterative process. Planning includes scheduling and determining the priorities of cost audit procedures and their inter-dependence. The cost auditor must use his professional judgement for the process to be followed in completing all essential planning activities. To develop an effective plan, the cost auditor should consult with senior management, audit committee and the Board, if required.

A.85 Matters that are relevant in formulating the overall audit strategy and drawing up the audit plan include the following:

- i) Prevailing cost reporting framework which forms the basis for preparation of cost records and cost statements and the need for reconciliation with financial reporting framework.
- ii) Industry regulators' requirement as to how costs will be handled.
- iii) Unique features of an industry that influence cost audit requirements. For example, definition of product in the newspaper industry.
- iv) Reliance that can be placed on the work of financial auditors, other cost auditors appointed by the entity and internal auditors. For example, their attendance in annual stocktaking.
- v) State of Information Technology implementation, whether the entity is using an Enterprise Resource Planning system or internally developed systems and reliance that can be placed on them.
- vi) The cost auditor's need to deploy IT tools, data mining & analytic procedures, and the expertise required for conducting the cost audit activities and testing procedures under an IT environment.
- vii) Adequacy and effectiveness of the entity's governance framework, and its risk management, and control processes.
- viii) Statutory timelines for cost reporting which can be modified by the management for early completion.
- ix) Timelines for Board/ audit committee meetings, which can set the time limits for completion of audit work.
- x) Resources required and available in terms of manpower, equipment and others and the assignment of these to specific parts of the work.



- A.86 The cost audit plan is more detailed than the overall cost audit strategy as it includes the nature, timing, and extent of cost audit procedures to be performed by audit team members. Planning for these cost audit procedures takes place over the course of audit as the cost audit plan for the engagement develops. For example, planning of the cost auditor's risk assessment procedures occurs early in the cost audit process. However, planning the nature, timing and extent of specific further cost audit procedures depends on the outcome of those risk assessment procedures.
- A.87 As a result of unexpected events, unexpected delay in availability of cost records, cost data & cost statement; changes in conditions leading to difficulty in smooth continuance of audit; or the audit evidence obtained from the results of audit procedures, the cost auditor may need to update or modify the overall audit strategy and audit plan. The cost auditor must review and adjust the plan, as necessary, in response to changes in the entity's business, risks, operations, programs, systems, and controls.

SCA-110, Cost Audit Materiality

R.39 While establishing the overall audit strategy, the cost auditor shall determine:

- (a) materiality level for the cost statements as a whole that is appropriate depending on the nature of industry, scale of operations and the regulatory requirements;***
- (b) separate materiality level or levels for one or more items of cost; and***
- (c) performance materiality for purposes of assessing the risks of material misstatement.***

R.40 The cost auditor shall revise the established materiality level or levels during the course of cost audit if the levels determined initially were found inappropriate.

Application and Explanatory Material

- A.88 Materiality refers to the relative size or rounding levels of amount, or minimum number of inputs consumption transactions set by the cost auditor for the purpose of auditing or reporting so as to reduce the audit risk or reporting risk. Cost auditor should set the materiality level(s) below which any errors are acceptably small and would not affect the decisions. Determination of materiality for the cost statements as a whole or for particular items of cost in an audit of the cost statements of an entity may be influenced by law, regulation or other



authority, and by the cost information needs of regulators, the government and other authority, in relation to its policies and programs.

A.89 The concept of materiality in the preparation and presentation of cost statements is further explained as under:

- a) Misstatements, including omissions, are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the decisions taken on the basis of the cost statements;
- b) Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
- c) Judgments about matters that are material to users of the cost statements are based on a consideration of the common cost information needs of users as a group. The possible effect of misstatements on specific individual user whose needs may vary widely is not considered.

A.90 Determining materiality involves an exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the cost statements as a whole. Factors that may affect the identification of an appropriate benchmark include:

- i) Nature of cost statement (for example, capacity, nature of products or services, cost of production or operation, cost of sales);
- ii) Nature of items to draw attention of the users of the entity's cost statements (for example for the purpose of evaluating cost statements users may tend to focus on valuation of material cost, utilities cost, primary packing material cost, apportionment of overheads);
- iii) Nature of the entity, where the entity is in its life cycle, and the industry and regulatory or non-regulatory sector in which the entity operates;
- iv) The entity's production or operational structure, production facilities, production units or locations of its operation (for example, an entity is manufacturing a single product on multi locations or manufacturing multi products on a single location, number of shifts, number of locations of rendering services); and
- v) The relative volatility of the benchmark.

A.91 Materiality relates to the cost statements on which the cost auditor is reporting. Where the cost statements are prepared for a cost reporting period of more or



less than twelve months, such as may be the case for a new entity or a change in the cost reporting period, materiality relates to the cost statements prepared for that cost reporting period.

A.92 Factors that may indicate the existence of one or more items of cost or disclosures for which misstatements of lesser amounts than materiality for the cost statements as a whole could reasonably be expected to influence the decisions of users taken on the basis of the cost statements include the following:

- i) Where law, regulation or the applicable cost reporting framework 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).
- ii) The key disclosures in relation to the industry in which the entity operates (for example, drilling costs in petroleum industry).
- iii) Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the cost statements (for example, land acquisition cost in construction industry).

A.93 Materiality for the cost statements as a whole or for particular items of cost may need to be revised as a result of a change in circumstances that occurred during the cost audit. For example, during the course of cost audit, if it appears that cost of certain goods sold is likely to be substantially different from that anticipated to determine materiality for the cost statements as a whole, the cost auditor revises that materiality.

SCA-111, Cost Audit Sampling

R.41 The cost auditor as part of the audit sampling shall consider the purpose of cost audit procedures and the characteristics of the population, its size and selection of items in such a way that each sampling unit in the population shall have the chance for testing.

R.42 The cost auditor shall perform cost audit procedure, appropriate to the purpose, on each selected item and if it is not applicable to the selected item, he shall perform it on the other items.

R.43 If the cost auditor is unable to apply the designated cost audit procedure to a selected item, he shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details.

Application and Explanatory Material



- A.94 Audit sampling is the use of audit procedures to less than 100% of the items. The need for audit sampling arises due to increasing complexities in business, cost auditor's time involved, and the volume of transactions involved in the business. The purpose of audit sampling is to obtain evidence, to fulfil the audit objectives set by the cost auditor, and to test the validity and accuracy of cost data and cost statements.
- A.95 In performing cost audit procedures, appropriately designed audit samples enable the cost auditor to obtain and evaluate audit evidence about some characteristic of the items selected to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can follow either statistical or non-statistical approach, which is decided not by the sample size but based on the professional judgement of cost auditor.
- A.96 The cost auditor shall include following consideration when designing an audit sampling:
- Specific purpose to be achieved;
 - Combination of audit procedure that is likely to best achieve audit purpose;
 - Nature of audit evidence sought;
 - Factors of possible deviation or misstatement conditions or other characteristics relating to audit evidence; and
 - Circumstances relevant to the purpose of audit procedures shall also be included for the purpose of evaluation of deviation or projection of misstatement.

These considerations shall also assist cost auditor in defining what constitutes a deviation or misstatement and what population to be used for sampling.

- A.97 In considering the characteristics of a population from which the sample is drawn for test of controls, the cost auditor should assess the expected rate of deviation based on his understanding of the relevant controls or on the examination of a small number of items from the population. This assessment shall be made to design an audit sample and to determine sample size. For example, if the expected rate of deviation is unacceptably high, the cost auditor shall normally decide not to perform tests of controls. Similarly, for tests of details, the cost auditor shall assess the expected misstatement in the population. If the expected misstatement in the population is high, 100% examination or use of a large sample size may be appropriate when performing tests of details.
- A.98 The cost auditor should evaluate the sample results to determine whether the assessment of the relevant characteristics of the population is confirmed or



whether it needs to be revised. For example, out of the sample selected, the cost auditor noted that two samples have no consumption during the period under cost audit. The cost auditor shall choose appropriate other samples to replace the original samples.

SCA-112, Written Representations

R.44 The cost auditor shall request management to provide a written representation that:

- (a) It has fulfilled its responsibility for the preparation of the cost statements in accordance with the applicable cost reporting framework, including, where relevant, their true and fair presentation, as set out in the terms of the cost audit engagement;**
- (b) It has provided the cost auditor with all relevant information and access as agreed in the terms of the cost audit engagement;**
- (c) All incomes and costs have been recorded and are reflected in the cost statements in accordance with the applicable Cost Accounting Standards and Generally Accepted Cost Accounting Principles;**
- (d) It has complied with the applicable legal and regulatory framework; and**
- (e) It has shared with the cost auditor all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects have been considered while preparing the cost statements.**

R.45 The cost auditor shall disclaim an opinion on the cost statements if the management does not provide one or more of the requested written representations required.

For reference, a model Representation Letter is appended at the end of this document as Appendix-II.

Application and Explanatory Material

A.99 Audit evidence obtained during the cost audit is not sufficient without obtaining written confirmation from the management that it has fulfilled its responsibilities as set out in the terms of cost audit engagement. Written representations draw on the agreed acknowledgement and understanding of management of its responsibilities in terms of the cost audit engagement by



requesting confirmation that it has fulfilled them. The cost auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is particularly appropriate when:

- i) Those who signed the terms of the cost audit engagement on behalf of the entity no longer have the relevant responsibilities;
- ii) The terms of the cost audit engagement were prepared in a previous year;
- iii) There is any indication that management misunderstands those responsibilities; or
- iv) Changes in circumstances make it appropriate to do so.

A.100 The mandate for cost audits of the cost statements of regulatory sector entities may be broader than those of other entities. As a result, the premise relating to management's responsibility on which audit of the cost statements of a regulated entity is conducted may give rise to additional written representations. These may include written representations confirming that the items of cost and events have been carried out in accordance with applicable law, regulation, or other authority and the cost statements have been prepared in accordance with the applicable cost reporting framework.

A.101 The cost auditor is not able to judge solely whether management has fulfilled its responsibilities referred to in the requirement paragraphs. For example, the cost auditor could not conclude that management has provided him with all relevant information as agreed to in the terms of the cost audit engagement without asking for it and receiving confirmation that all such information has been provided. Therefore, if cost auditor concludes that the written representations about these matters are unreliable, or if management does not provide those written representations, it means that the cost auditor is unable to obtain sufficient appropriate cost audit evidence. The possible effects of such inability are not confined to specific elements or items of cost and the cost statements and are hence pervasive. In such circumstance, the cost auditor should disclaim or qualify an opinion on the cost statements.

A.102 A written representation that has been modified from that requested by the cost auditor does not necessarily mean that management did not provide the written representation. However, the underlying reason for such modification may affect the opinion in the cost auditor's report. For example, the written representation about management's fulfilment of its responsibility for the preparation of the cost statements may state that management believes that, except for material non-compliance with a particular requirement of the applicable cost reporting



framework, the cost statements are prepared in accordance with that framework. This is not absolute compliance with the requirement. Hence, the cost auditor is required to consider the effect of such non-compliance on his opinion in the cost auditor's report.

SCA-113, Cost Audit Procedures and Evidence

R.46 The cost auditor shall design and perform cost audit procedures that are relevant in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

R.47 The cost auditor shall consider and evaluate the relevance, reliability, accuracy, and completeness of the information to be used as audit evidence when designing and performing cost audit procedures.

R.48 When designing and performing substantive analytical procedures, the cost auditor shall determine its suitability for given assertions and evaluate the reliability of cost data taking account of source, comparability, consistency, nature, and relevance.

R.49 The cost auditor shall determine extent of modification or addition to cost audit procedures that are necessary if audit evidence obtained from one source is inconsistent with that obtained from another; or the cost auditor has doubts over the reliability of information to be used as audit evidence.

R.50 The cost auditor shall examine external confirmation procedures followed by the management wherever appropriate under the applicable cost reporting framework. He shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary.

R.51 The cost auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the cost statements and the date of the cost auditor's report that require adjustment of, or disclosure in, the cost statements have been identified and appropriately reflected in those cost statements in accordance with the applicable cost reporting framework.

Application and Explanatory Material

A.103 The cost auditor should apply cost audit procedures to obtain and evaluate audit evidence that is required in forming the opinion. Such cost audit procedures can include inquiry, inspection, observation, recalculation, reperformance, and analytical procedures, often in some combination.



- A.104 The nature and timing of the audit procedures to be used may be affected by the fact that some of the cost data and other information may be available only in electronic form or only at certain points or periods in time that may not be retrievable after a specified period. Accordingly, keeping in view the entity's data retention policy, the cost auditor may find it necessary to perform audit procedures at a time when the information is available.
- A.105 Inspection of cost records and other documents provides audit evidence of varying degrees of reliability, depending on their nature and source. Observation consists of looking at a process or procedure being performed by others, for example, the cost auditor's observation of input-output ratio, or of the performance of any production process. Recalculation consists of checking the mathematical accuracy of data or records; it may be performed manually or electronically. Reproduction involves the cost auditor's independent execution of procedures or controls that were originally performed by the entity as part of its internal control.
- A.106 An external confirmation represents audit evidence obtained by the cost auditor as a direct written response to the entity from a third party (the confirming party), in paper form or by electronic or other medium. External confirmation procedures are relevant when addressing assertions associated with certain documents, terms of agreements or transactions the entity has with third parties, stock balances, etc.
- A.107 Inquiry consists of seeking information of knowledgeable persons, within the entity or outside the entity. Inquiry is used extensively throughout the cost audit in addition to other cost audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
- A.108 Relevance of audit evidence refers to its relationship to the assertion or to the objective of the control being tested. Relevance deals with the logical connection with, or bearing upon, the purpose of the cost audit procedure and, where appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction of testing. For example, if the purpose of cost audit procedure is to test for overstatement or understatement in valuation of finished goods inventory, testing the records of production and sales (including physical dispatches) may be a relevant audit procedure. In addition, testing records relating to subsequent production, work in progress, consumption statements, and utilities consumption reports may be relevant.



A.109 The reliability of information to be used as audit evidence is influenced by its source, nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable or it lacks objectivity. While recognizing that exceptions may exist, following generalizations about the reliability of audit evidence may be useful:

- i) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- ii) The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- iii) Audit evidence obtained directly by the cost auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- iv) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of internal report is more reliable than an oral representation of the matters discussed).
- v) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitised, or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance of those documents.

A.110 Analytical procedures consist of evaluation of cost information made by a study of plausible relationships among both cost and non-cost items. Analytical procedures also encompass the investigation of identified variations and relationships that are inconsistent with other relevant information or deviate significantly from predicted cost structure and may be extended to analysis of technical parameters to derive the variance.



- A.111 Tests of controls are designed to evaluate the operating effectiveness of controls in preventing or detecting and correcting material misstatements at the assertion level. Designing tests of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control, and deviation conditions which indicate departures from adequate performance. The presence or absence of those conditions can then be tested by the cost auditor.
- A.112 Substantive procedures are designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures. Designing substantive procedures include identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion.
- A.113 The cost auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the cost auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.
- A.114 The cost auditor may inquire from management as to the availability and reliability of cost information needed to apply substantive analytical procedures, and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided the cost auditor is satisfied that such data is properly prepared.
- A.115 Different types of analytical procedures provide different levels of assurance. Analytical procedures involving material cost % to total cost, material wastage as % to total input, contribution per unit of material used, production per man hour, production per employee, employee cost % to cost of goods sold, Idle hours % to total available hours, production per machine hour, growth in machine capacity utilisation, machine downtime ratio, break-down hours etc. can provide persuasive evidence or may eliminate the need for further verification by means of tests of details, provided the ratios are correctly calculated.
- A.116 If audit evidence obtained from one source is inconsistent with that obtained from another, or if the cost auditor has doubts about the reliability of information to be used as audit evidence, the cost audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the cost audit. The cost auditor's evaluation may assist in concluding whether



sufficient appropriate audit evidence has been obtained or whether further audit evidence is necessary.

A.117 Depending on the cost auditor's risk assessment, the audit procedures may include procedures necessary to obtain sufficient appropriate audit evidence, involving the review or testing of accounting records or transactions occurring between the date of the cost statements and the date of the cost auditor's report. The audit procedures are in addition to procedures that the cost auditor may perform for other purposes that, nevertheless, may provide evidence about subsequent events (for example, to obtain audit evidence for stock balances as at the date of the cost statements, such as cut off procedures or procedures in relation to subsequent receipts of stocks receivable).

SCA-114, Related Parties

R.52 The cost auditor shall inquire of management regarding:

- (a) The identity of the entity's related parties, including changes from the prior period;**
- (b) The nature of the relationships between the entity and these related parties;**
- (c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and business purpose of the transactions;**
- (d) Whether management has authorized and approved significant transactions and arrangements with related parties including those outside the normal course of business, as required by law or regulation;**
- (e) Whether management has accounted for and disclosed related party relationships and transactions in accordance with the applicable cost reporting framework; and**
- (f) Such other records or documents as the cost auditor considers necessary in the circumstances of the entity.**

R.53 If management has made an assertion in the cost statements to the effect that a related party transaction was conducted on the normal price, the cost auditor shall obtain sufficient appropriate audit evidence about the assertion.

Application and Explanatory Material



- A.118 Where the applicable cost reporting framework establishes related party requirements, information regarding the identity of the entity's related parties is likely to be readily available because the entity's information systems will need to record, process, and summarize related party relationships and transactions to enable it to meet the accounting and disclosure requirements of the applicable framework. The cost auditor should obtain necessary information regarding the entity's related parties & details of transactions with them during the period under cost audit.
- A.119 In evaluating the business rationale of a significant related party transaction outside the entity's normal course of business, the cost auditor may consider the following:
- i) Whether the transaction is overly complex, has unusual terms of trade, lacks an apparent logical business reason for its occurrence, involves previously unidentified related parties, and is processed in an unusual manner.
 - ii) Whether management is placing more emphasis on a particular accounting or cost accounting treatment rather than giving due regard to the underlying economics of the transaction.
 - iii) When the management's explanations are materially inconsistent with the terms of the related party transaction(s).
 - iv) When business rationale of the transaction with related party appears inconsistent with the nature of its business.
 - v) Where the related party transaction represents a fraud risk factor.
- A.120 Authorization and approval by the management of significant related party transactions outside the entity's normal course of business may provide audit evidence that these have been duly considered at the appropriate level(s) within the entity and that their terms and conditions have been appropriately reflected in the cost statements. The existence of transactions of this nature that were not subject to such authorization and approval, in the absence of any rational explanations, may indicate risks of material misstatement due to fraud. In these circumstances, the cost auditor may need to be on alert for other transactions of similar nature. Authorization and approval alone, however, may not be sufficient in concluding whether the risks of material misstatement due to fraud are absent because authorization and approval may be ineffective if there has been collusion between the related parties or if the entity is subject to dominant influence of a related party.



- A.121 Evaluating related party disclosures in the context of disclosure requirements of the applicable cost reporting framework means considering whether the facts and circumstances of the entity's related party relationships and transactions have been appropriately summarized and presented so that the disclosures are understandable. Disclosures of related party transactions may not be understandable if the business rationale and effects of such transactions on the cost statements are unclear or misstated; or their key terms, conditions, or other important elements are not appropriately disclosed, as required by the applicable cost reporting framework or by law or regulation.
- A.122 Preparation of cost statements require the management to substantiate an assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction. Management's support for the assertion may include comparing the terms of related party transaction to those of an identical or similar transaction with one or more unrelated parties or to the known market terms for broadly similar transactions on an open market.
- A.123 Evaluating management's support for this assertion may involve considering the appropriateness of management's process for supporting the assertion; verifying the source of internal or external data supporting the assertion, and testing its accuracy, completeness, and relevance; and evaluating the reasonableness of any significant assumptions on which the assertion is based.
- A.124 Some cost reporting frameworks require the disclosure of related party transactions not conducted on terms equivalent to those prevailing in arm's length transactions. In these circumstances, if management has not disclosed a related party transaction in the cost statements, there may be an implicit assertion that the transaction was conducted on terms equivalent to those prevailing in an arm's length transaction.

SCA-115, Corresponding Figures and Comparative Cost Statements

R.54 The cost auditor shall determine whether the cost statements include the comparative information required by the applicable cost reporting framework and whether such information is appropriately classified. For this purpose, the cost auditor shall evaluate whether:

- (a) The comparative information agrees with the amounts and other disclosures presented in the prior period or, when appropriate, have been restated; and***
- (b) The cost accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been***



changes in the cost accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

R.55 If the cost auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the cost auditor shall accordingly base his opinion on the current period's cost statements.

R.56 If the cost statements of the prior period were audited by a predecessor cost auditor, the cost auditor shall state so in the Disclosure paragraph. If the cost auditor's opinion differs from the opinion the cost auditor previously expressed, the cost auditor shall disclose the substantive reasons for the different opinion.

R.57 If the prior period cost statements were not audited, the cost auditor shall state in the Disclosure paragraph that the comparative cost statements are unaudited.

R.58 If the entity's financial statements were not audited till the time of completion of cost audit, the cost auditor shall disclose it in his audit report.

Application and Explanatory Material

A.125 The cost auditor should look that the cost statements include the comparative information required by the applicable cost reporting framework and the same is appropriately classified. The cost auditor shall evaluate whether the comparative information agrees with the amounts and other disclosures presented in the prior period or, when appropriate, have been restated and the cost accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in the cost accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

A.126 When the cost auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the cost statements in accordance with the applicable cost reporting framework, the cost auditor's opinion on the current period need not refer to the previous modification.

A.127 When the cost auditor's opinion on the prior period, as previously expressed, was modified, the unresolved matter that gave rise to the modification may not be relevant to the current period figures. Nevertheless, an express opinion alongwith necessary disclosure may be required on the current period's cost



statements because of the effects or possible effects of the unresolved matter on the comparability of the current and corresponding figures.

- A.128 During the course of audit for the current year, the cost auditor finds that the prior period cost statements were later amended, and the predecessor cost auditor is either unable or unwilling to reissue the cost auditor's report on the amended prior period cost statements. If the cost auditor obtains sufficient appropriate audit evidence to be satisfied as to the appropriateness of the amendment, the cost auditor's report may include the following paragraph:

"As part of our audit of the year 20X2 cost statements, we also audited the adjustments described in Note X that were applied to amend the 20X1 cost statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 20X1 cost statements of the company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 20X1 cost statements taken as a whole."

- A.129 If the prior period cost statements were not audited, the cost auditor shall state in the Disclosure paragraph that the comparative cost statements are unaudited. Such a statement does not, however, relieve the cost auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's cost statements.
- A.130 If the entity's financial statements were not audited till the time of completion of cost audit, the cost auditor shall disclose it in his audit report.

SCA-116, Evaluation of Cost Audit Risks, Misstatements or Frauds

R.59 The cost auditor shall accumulate all material misstatements identified during the cost audit, evaluate, and communicate to the management their effect on the classification, measurement, and assignment of cost to the cost objects or disclosures in the cost statements. The cost auditor shall request management to correct those misstatements. If the management does not correct, he shall evaluate and make adequate disclosure in his audit report.

R.60 The cost auditor shall design and perform audit procedures & test of controls to identify and address significant risks of material misstatement, if any, in the cost statements. He shall obtain sufficient appropriate and more persuasive audit evidence with respect to the operating effectiveness of relevant controls in areas where any significant risks of material misstatement have been identified.



R.61 *The cost auditor shall obtain written representations from the management that:*

- (a) They acknowledge their responsibility for the design, implementation, and maintenance of internal control over cost records to prevent and detect fraud;*
- (b) They have disclosed to the cost auditor the results of management's assessment of the risk that the cost statements may be materially misstated because of fraud;*
- (c) They have disclosed to the cost auditor their knowledge of fraud, or suspected fraud, if any, affecting the entity involving management, employees, or others where the fraud could have effect on the cost statements; and*
- (d) They have disclosed to the cost auditor their knowledge of any allegations of fraud, or suspected fraud communicated by employees, former employees, analysts, regulators, or others, affecting the entity's cost statements.*

R.62 *The cost auditor shall make inquiries from the internal audit or external audit team to determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity.*

R.63 *If the cost auditor has identified a fraud or has obtained information that indicates that a fraud may exist, he shall communicate these matters to the appropriate level of management, and regulators, on a timely basis, as prescribed by law or regulation.*

R.64 *If as a result of a misstatement resulting from fraud or suspected fraud, the cost auditor encounters exceptional circumstances that bring into question his ability to continue performing the cost audit, he shall consider whether it is appropriate and legally permitted to withdraw from the engagement; and report to the appropriate persons within or outside the entity and regulators, alongwith the reasons for his withdrawal, as required by law or regulation.*

Application and Explanatory Material

A.131 During the cost audit, the cost auditor should find all material misstatements and distinguish whether these are trivial or not. The cost auditor may fix criteria for identifying misstatements that would be clearly trivial and would not need to be accumulated because he expects that the accumulation of such amounts clearly would not have a material effect on the cost statements.



A.132 The cost auditor shall evaluate the effect of all such misstatements that are not trivial and communicate to the management. The cost auditor may distinguish between factual misstatements, judgmental misstatements, and projected misstatements.

- i) Factual misstatements are misstatements about which there is no doubt.
- ii) Judgmental misstatements are differences arising from the judgment of management concerning cost estimates that the cost auditor considers unreasonable, or the selection or application of costing principles, methods, and policies that the cost auditor considers inappropriate.
- iii) Projected misstatements are the cost auditor's estimate of misstatements in populations based on misstatements identified in audit samples of those entire populations.

A.133 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.

A.134 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 cost auditor's projection of misstatements identified in cost audit sample to the entire population from which it was drawn.

A.135 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.

A.136 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.



- A.137 The cost auditor must perform detailed audit procedures & test of controls to identify significant risks of material misstatement, if any, in the cost statements. Owing to higher assessment of risk, the cost auditor should obtain more persuasive audit evidence from independent & reliable sources. A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, more so where it is not possible or practicable to obtain sufficient appropriate audit evidence only from the substantive procedures.
- A.138 Appropriate written representations may be obtained from the management acknowledging that they have fulfilled their responsibility for the preparation of cost statements and the management acknowledges its responsibility for implementation of effective internal controls to prevent and detect fraud. In addition, the cost auditor should obtain a written representation from management confirming that they have disclosed to the cost auditor:
- i) The results of management's assessment of the risk that the cost statements may be materially misstated as a result of fraud; and
 - ii) Their knowledge of actual, suspected, or alleged fraud affecting the entity.
- A.139 The cost auditor may inquire about specific internal audit activities covering potential areas of possibility of a fraud. For example, the procedures performed, if any, by the internal auditors during the year to detect fraud and whether management has satisfactorily responded to any findings resulting from those procedures.
- A.140 The cost auditor's communication with the management may be made orally or in writing in accordance with the importance of the matter. However, where the cost auditor has identified a misstatement resulting from fraud or suspected fraud involving senior management or employees or otherwise, he shall report such matters to the appropriate level of management, in writing and on a timely basis. In addition, the cost auditor shall also report to the regulators as prescribed by law or regulation. The determination of which level of management is the appropriate one is a matter of professional judgment and is affected by such factors as the likelihood of collusion and the nature and magnitude of the suspected fraud. Ordinarily, the appropriate level of management is at least one level above the persons who appear to be involved with the suspected fraud.
- A.141 If as a result of a misstatement resulting from fraud or suspected fraud, the cost auditor encounters exceptional circumstances that bring into question his ability to continue performing the cost audit, he shall consider whether it is appropriate



and legally permitted to withdraw from the engagement; and report to the appropriate persons within or outside the entity and regulators, alongwith the reasons for his withdrawal, as required by law or regulation. Few examples of exceptional circumstances that may arise and that may bring into question the cost auditor's ability to continue performing the cost audit include:

- i) The entity does not take appropriate action regarding fraud that the cost auditor considers necessary in the circumstances, even where the fraud is not material to the cost statements;
- ii) The cost auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests indicate a significant risk of material and pervasive fraud; or
- iii) The cost auditor has significant concern about the competence or integrity of management.

A.142 The cost auditor has professional and legal responsibilities in such circumstances and these responsibilities may vary. For example, the cost auditor may be entitled to, or required to make a statement or report to the person or persons who made his appointment or, in some cases, to regulatory authorities. Given the exceptional nature of the circumstances and the need to consider the legal requirements, the cost auditor may consider it appropriate to seek legal advice when deciding whether to withdraw from an engagement and in determining an appropriate course of action, including the possibility of reporting to shareholders, regulators, or others.

Category: Formation of Opinion and Reporting

SCA-117, *Forming an Opinion and Reporting on Cost Statements*

R.65 *The cost auditor shall evaluate and form an opinion on the following:*

- (a)** *Whether the cost statements are prepared, in all material respects, in accordance with the applicable cost reporting framework and cost accounting standards;*
- (b)** *Whether the cost statements as a whole are free from material misstatement, whether due to fraud or error and give a true and fair view;*



- (c) Whether the cost statements adequately disclose the significant cost accounting policies selected and applied that are consistent, reasonable and appropriate;**
- (d) Whether the information presented in the cost statements is relevant, reliable, comparable, and understandable;**
- (e) Whether the cost statements provide adequate disclosures to enable the intended users to understand the information conveyed in the cost statements;**
- (f) Whether the terminology used in the cost statements, including the title of each cost statement, is appropriate; and**
- (g) Whether in order to form that opinion, the cost auditor has obtained reasonable assurance & appropriate audit evidence.**

R.66 The cost auditor shall express an unqualified opinion when he concludes that the cost statements are prepared, in all material respects, in accordance with the applicable cost reporting framework and are free from material misstatement, whether due to fraud or error.

R.67 Cost auditor's report shall be in writing as per the applicable reporting framework or as per specific layout or wording required by law or regulation.

R.68 The cost auditor shall qualify the opinion in his audit report when he concludes that, based on the audit evidence obtained, the cost statements are not free from material misstatement; or he is unable to obtain sufficient appropriate audit evidence to conclude that the cost statements are free from material misstatement.

R.69 When the cost auditor qualifies the opinion on the cost statements, he shall include a paragraph in his audit report that provides a narrative description of the matter giving rise to the qualification, including non-disclosure of material information if any, alongwith the effect on cost, unless not material and significant.

R.70 If the cost auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and he concludes that the possible effects on the cost statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, he may:

- (a) Withdraw from the audit, where practicable and possible under applicable law or regulation and determine whether there is any**



obligation to report the circumstances to other parties, such as owners or regulators; or

(b) If withdrawal from the audit before issuing his audit report is not practicable or possible, disclaim an opinion on the cost statements. The cost auditor shall further state that he has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; and, accordingly, he does not express an opinion on the cost statements.

Application and Explanatory Material

- A.143 The cost auditor shall form an opinion after considering all aspects of audit of the cost statements as a whole prepared by the management as per the applicable cost reporting framework that are based on the consistent use of relevant cost accounting policies and has made adequate & reliable disclosures.
- A.144 The cost auditor's opinion should be formed after obtaining sufficient appropriate audit evidence with respect to the management's assertion that the cost statements are free from material misstatement, whether due to fraud or error and give a true and fair view of the per-unit cost of production/operation, cost of sales, and margin for each of the entity's product & service. Further, the cost auditor should evaluate whether the cost statements enable the intended users to understand the effect of material transactions and events on the entity's cost performance.
- A.145 The preparation of the cost statements by management requires inclusion of an adequate description of the applicable cost reporting framework in the cost statements. A description is appropriate only if the cost statements comply with all the requirements of that framework. A description that contains imprecise qualifying or limiting language (for example, "the cost statements are in substantial compliance with applicable Cost Accounting Standards") is not an adequate description of that framework as it may mislead users of the cost statements.
- A.146 In cases where law or regulation prescribes the wording of the cost auditor's report, which also includes the cost auditor's opinion, in terms that is significantly different from the requirements of standards on cost auditing (SCAs), the cost auditor should not include any reference in his report that the cost audit has been conducted in accordance with SCAs. Further, the cost auditor should also evaluate whether any additional explanation in his report is required to mitigate possible misunderstanding by the users. If the cost auditor concludes that such additional explanation cannot mitigate possible misunderstanding, the



cost auditor should not accept the audit engagement, unless required by law or regulation to do so.

A.147 A written report encompasses reports issued in hard copy format and those using an electronic medium.

A.148 Cost auditor, in order to form an opinion on the cost statements, to conclude whether reasonable assurance has been obtained about whether the cost statements as a whole are free from material misstatement. A material misstatement of the cost statements may arise in relation to:

- i) The appropriateness of the selected cost accounting policies;
- ii) The application of the selected cost accounting policies; or
- iii) The appropriateness or adequacy of disclosures in the cost statements.

A.149 In relation to the appropriateness of the cost accounting policies management has selected, material misstatements of the cost statements may arise when:

- i) The selected cost accounting policies are not consistent with the applicable cost reporting framework; or
- ii) The cost statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves their fair presentation.

A.150 In relation to the application of the selected cost accounting policies, material misstatements of the cost statements may arise:

- i) When management has not applied the selected cost accounting policies consistently with the cost reporting framework; or
- ii) Due to the method of application of the selected cost accounting policies (such as an unintentional error in application).

A.151 In relation to the appropriateness or adequacy of disclosures in the cost statements, material misstatements of the cost statements may arise when:

- i) The cost statements do not include all disclosures required by the applicable cost reporting framework;
- ii) The disclosures in the cost statements are not presented in accordance with the applicable cost reporting framework; or
- iii) The cost statements do not provide the disclosures necessary to achieve fair presentation.



A.152 The cost auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from the following.

- i) Circumstances beyond the control of the entity;
- ii) Circumstances relating to nature or timing of the cost auditor's work; or
- iii) Limitations imposed by the management.

A.153 Examples of circumstances beyond the control of the entity include when:

- i) The entity's cost accounting records have been destroyed.
- ii) The cost accounting records of a significant component have been seized indefinitely by governmental authorities.

A.154 Examples of circumstances relating to the nature or timing of the cost auditor's work include when:

- i) The timing of the cost auditor's appointment is such that the cost auditor is unable to observe the performance of certain operations or activities (for example, counting of the physical inventories).
- ii) The cost auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

A.155 Limitations imposed by management may have other implications for the cost audit, such as for the cost auditor's assessment of fraud risks and consideration of engagement continuance. However, an inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the cost auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures.

A.156 Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:

- i) Management prevents the cost auditor from observing the performance of certain operations or activities (for example, counting of the physical inventories).
- ii) Management prevents the cost auditor from requesting external confirmation of specific account balances or transactions.

Inclusion of this paragraph makes it clear to the user that the cost auditor's opinion is qualified and indicates the reason of the qualification.



- A.157 When the cost auditor expresses a qualified opinion, it would not be appropriate to use phrases such as “with the foregoing explanation” or “subject to” in the opinion paragraph as these are not sufficiently clear or forceful.
- A.158 When the cost auditor is unable to obtain sufficient appropriate audit evidence and concludes that the possible effects of undetected misstatements in the cost statements could be material and pervasive, and a qualification of the opinion would be inadequate to communicate the gravity of the situation, he may withdraw from the cost audit, where permissible under law or regulation and determine whether there is any obligation to report the circumstances to other parties, such as owners or regulators. However, if withdrawal from the cost audit before issuing his audit report is not practicable or possible, he may disclaim an opinion on the cost statements citing reasons.
- A.159 The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the cost auditor has substantially completed the audit, the cost auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation in the Basis for Disclaimer of Opinion paragraph prior to withdrawing.
- A.160 When the cost auditor concludes that withdrawal from the audit is necessary because of a scope limitation, there may be a professional, legal, or regulatory requirement for the cost auditor to communicate matters relating to the withdrawal from the engagement to regulators or the entity’s owners.
- A.161 In certain circumstances, withdrawal from the audit may not be possible if the cost auditor is required by law or regulation to continue the audit engagement. This may be the case for a cost auditor who is appointed by the regulators to audit the cost statements of public sector entities. It may also be the case where the cost auditor is appointed to audit the cost statements covering a specific period or appointed for a specific period and is prohibited from withdrawing before the completion of the audit of those cost statements or before the end of that period, respectively.

SCA-118, Communicating Key Audit Observations and Suggestions

R.71 Besides giving his opinion on the audit of cost statements, the cost auditor shall communicate his key audit observations and suggestions that emerged from his

- (a) review of the entity’s cost accounting & control systems, cost flow processes, risk management framework, and effectiveness of IT systems;***



- (b) performing analytical procedures relating to cost flow to different products/ activities, cost centres, and cost objects; and**
- (c) undertaking cost data analysis, and operational analysis.**

R.72 The cost auditor shall perform audit procedures to form his opinion that the entity has maintained cost records on regular basis in such manner so as to,

- (a) facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of the entity's products and activities on monthly, quarterly, half-yearly and annual basis; and**
- (b) enable the entity to exercise, as far as possible, control over the various operations and costs to achieve optimum economies in utilisation of resources.**

R.73 While analysing the entity's control over various operations and costs, the cost auditor should evaluate the economy, efficiency, & effectiveness of its internal control & cost flow systems and perform analysis of Input(s) vs. Output(s) of each plant/unit, process, activity, product, material, utility, etc., as per his terms of engagement. The cost auditor should provide such information to the Audit Committee/ Board that is critical to take suitable actions to optimize resource allocation and utilization thereof.

R.74 In terms of outcomes of cost audit, the management should be able to identify areas, activities, processes, products, services, etc. that requires improvement. The cost auditor should suggest areas to bring improvements in Productivity, Value creation, Profitability, Risk management, and Sustainability.

R.75 The cost audit should lay thrust on the cost management and efficiency/ productivity aspects of the business and should effectively bring out comments on how the business performance could be improved by elevating the outcome performance. The cost auditor should assess the impact of changes on the profitability of products, customers, and market segments.

R.76 For being a valuable document, cost auditor's report should portray analysis of a range of performance measures. While selecting these measures, he should include those measures that have material impact on the past or future performance of the entity. The criteria that may help the cost auditor to select and include in his audit report are effect on profitability, resource utilisation, liquidity, risks management, quality, competitiveness, and responsiveness to the market etc.

Application and Explanatory Material



A.162 As part of performing cost audit of the designated units, products, & activities, and to obtain sufficient appropriate audit evidence, the cost auditor shall undertake analysis of the cost data to check its validity and accuracy from different perspectives. For doing so, the cost auditor should review the entity's cost accounting, cost flow, and cost control systems & processes. In addition, the cost auditor should also perform detailed analytical procedures in respect of the entity's operations, consumption ratios, impact of major cost elements, and their comparison with the previous best. Therefore, besides giving his opinion on the audit of cost statements, the cost auditor shall communicate his key audit observations and suggestions with respect to the efficiency and effectiveness of entity's operations, cost control systems & related IT framework, and free flow of cost to different products/activities, cost centres, and cost objects.

A.163 The prime objective of cost data analysis and operational analysis should be

- a) to identify cost savings by reducing or eliminating undesirable functions, activities, or services;
- b) to uncover the opportunities for improvement of performance and creation/ enhancement of value of the business;
- c) to find ways to improve operations and facilitate decision making by the entity with responsibility to initiate corrective action; and
- d) to identify right measures to guide continuous improvement.

A.164 It is the responsibility of management to prepare cost records and cost statements in accordance with the applicable cost reporting framework and cost accounting standards. These cost records and cost statements should give true & fair view of the entity's per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities; and enable it to exercise control over its operations and costs to achieve optimum economies in the utilisation of available resources. The cost auditor should perform audit procedures to form his opinion that the entity has maintained cost records and prepared cost statements for all its operational areas, activities, processes, products, and services. In terms of outcomes of cost audit, the cost auditor should suggest areas to improve the entity's operations & activities with an objective to bring discernible change in productivity, value creation, profitability, risk management, and sustainability.

A.165 As part of audit of the cost statements of the entity, the cost auditor primarily analyses whether the entity's operations/activities are being performed in accordance with the principles of economy, efficiency, and effectiveness and whether there is room for improvement. Where appropriate, the cost auditor



may also consider the impact of regulatory framework on the performance of the entity.

- a) The principle of economy means minimizing the costs of resources. The resources (human, financial and material) deployed should be of appropriate quantity and quality, available in due time, and at the best price. Therefore, economy indicates incurring of the least possible cost for acquiring and/or utilizing the resources, without compromising the quality.
- b) The principle of efficiency means getting the most from the available resources. It is concerned with the relationship between resources deployed and outputs delivered in terms of quantity, quality, and timing.
- c) The principle of effectiveness concerns meeting the objectives set and achieving the intended results. Effectiveness is essentially a goal-attainment concept. The cost auditor should cover, at the minimum, all the three aspects of operations and cost management.

A.166 For evaluating performance of any unit, function, process, product, customer, or market, the cost auditor may use such Key Performance Indicators (KPIs) that are easily understood and actionable for the operational executives to relate what is being done and what needs to be done. The cost auditor, to the best of his professional knowledge, skill & judgement, may select and include such performance measurement criteria that cause visible effect on the entity's profitability, resource utilisation, liquidity, risks, quality, competitiveness, and responsiveness to the market. An ideal cost & performance evaluation report should be objective and comprehensive covering strategic thrust areas, duly backed by conclusions reached based on detailed cost & performance data analytics.



Illustrative Cost Audit Engagement Letter

The following is an illustrative draft of cost audit engagement letter for an audit of cost records prepared in accordance with the Companies (Cost Records and Audit) Rules 2014 framed under the Companies Act 2013. This may be modified as per the type/size of the company, scope of cost audit, requirements under SCAs, & other applicable laws & regulations.

The Board of Directors
ABC Company

[The objective and scope of the cost audit]

You have requested that we audit the cost statements of _____ (name of the units to be audited) covering the cost of _____ (name the products/services to be covered under cost audit) of your Company for the financial year _____ in accordance with the Companies (Cost Records and Audit) Rules 2014 notified under section 148 of the Companies Act 2013, in order to give:

1. True and fair view of the cost of production/operations, cost of sales, and margin for each product/service/activity, produced or provided by the company.
2. Reconciliation of profits, as per cost accounts and as per financial accounts;
3. Statement of value addition and distribution of earnings; and
4. Any explanatory note annexed to, or forming part of, any document referred to in (1) to (3) above.

We are pleased to confirm our acceptance and our understanding of this cost audit engagement by means of this letter.

[The responsibilities of the cost auditor]

We will conduct the cost audit in accordance with standards on cost auditing issued by the Institute of Cost Accountants of India with the approval of the Central Government. These standards require the cost auditor:

1. To 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.



2. To evaluate the appropriateness of cost accounting policies used and reasonableness of cost accounting estimates made by the management, as well as evaluating the overall presentation of the cost statements.
3. To consider your company's internal controls with a view to design cost audit procedures that are appropriate in the circumstances.
4. To communicate with you in writing any significant deficiencies in internal controls relevant to the audit of cost statements that we may identify during the cost audit.
5. To furnish report on the audit of cost records in accordance with the Companies (Cost Records and Audit) Rules 2014 notified under section 148 of the Companies Act 2013.

[The responsibilities of management]

Our cost audit will be conducted on the basis that management acknowledges and understands that they have responsibility:

- (a) For the preparation and presentation of cost statements in accordance with the Companies (Cost Records and Audit) Rules 2014 notified under section 148 of the Companies Act 2013, 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, as relevant & applicable to the company. This includes giving proper explanation relating to material departures from those cost accounting standards, if any;
- (d) For such internal controls as the management determines necessary to enable preparation of cost statements that are free from material misstatement, whether due to error or fraud;
- (e) To provide the us with:
 - a. Access to all information, including the books of accounts, vouchers, cost records, technical information, quantitative data, IT system, 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 we may request from the management for the purpose of cost audit; and
 - c. Unrestricted access to persons within the company from whom we determine it is necessary to obtain cost audit evidence.



- d. *[add if appointed as Lead Cost Auditor]* Access to all the cost statements, reports, audit findings, & opinions of all other cost auditors, including other matters affecting the cost statements of the units & products audited by them.

As part of our cost audit process, we will request from management, 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.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our cost audit of the cost statements including our respective responsibilities.

XYZ & Co.

Cost Auditors

(Proprietor/Partner)

Acknowledged and agreed on behalf of ABC Company by

(Signed)

.....

Name and Title

Date



Appendix-II

Illustrative Representation Letter

The following illustrative Letter of Representation is for use as a general guide with reference to the points mentioned in this respect. It may vary from one company to another and from one year to another. Therefore it can be adapted in view of individual requirements and circumstances.

(Company's letter head)

Date:

To,

M/S

Cost Accountants

Dear Sir/Madam

This representation letter is provided in connection with your audit of cost statements of _____ (name of the Units to be covered) for the _____ (name of the products/services/activities to be audited) for the year ended _____ with the purpose of expressing an opinion as to whether the cost statements/abridged cost statements give a true and fair view of the cost of production or cost of operation, cost of sales and margin for each of the products, services and activities covered by audit.

COST STATEMENTS

We confirm to the best of our knowledge and belief that -

1. We have fulfilled our responsibilities as set out in the terms of the audit engagement letter dated _____ for the preparation of cost statements and to ensure that the cost statements have been prepared in accordance with the applicable laws and the Cost Accounting Standards (CASs) issued by the Institute of Cost Accountants of India, wherever relevant & applicable, in particular to ensure that the cost statements give a true and fair view cost of production or cost of operation, cost of sales and margin for each of the products, services and activities under cost audit.
2. The list of cost accounting policies followed by the company in the preparation of cost statements as provided to you is complete and is issued with the approval of competent management.



3. We have maintained necessary cost records and have prepared & presented the cost statements in accordance with the Companies (Cost Records and Audit) Rules 2014 notified under section 148 of the Companies Act 2013, for the period under audit.
4. We have corrected the misstatements in the cost statements reported by you in the course of audit. The effects of uncorrected misstatements, if any, are not material, both individually and in the aggregate in the cost statements as a whole. A list of the uncorrected misstatements is attached to this letter.

MATTERS RELATING TO OPERATIONS

5. The capacity of product(s)/service(s) is determined in accordance with manufacturer's specifications or technical assessments. These specifications are current and are applicable to the conditions prevailing in the audit year.
6. There is no change in the installed capacity, manufacturing or operating process or technology during the year as compared to previous year, which have not been disclosed to you.
7. We have provided you with access to all production / service facilities required for the purpose of Cost Audit.
8. Where we were unable to provide you information on materials used, processes employed etc. on grounds of confidentiality, we have provided you with adequate surrogate information to enable you to satisfy yourselves on the correct determination of costs.

COST MEASUREMENT AND ASSIGNMENT

9. All significant assumptions used by us in making cost estimates are reasonable. There is no change in the cost accounting system followed by the company for identification of cost centers / cost objects, cost drivers, accounting for materials, allocation and absorption of overheads, basis of inventory valuation system, and method of charging depreciation or amortization followed by the company as compared to previous year.
10. We have applied our best judgment in determining the amount of costs which are abnormal and non-recurring and excluded such amounts from costs.
11. The cost statements containing product/service/activity-wise cost details have been properly compiled and reconciled with financial accounts. No costs relating to prior periods have been included in the cost statements for the current year.
12. Losses have been distinguished from costs and are not included in the cost statements.



13. Fines, penalties, damages and similar levies paid to statutory authorities or other third parties are not included in cost.
14. All subsidies / grants or amounts of similar nature received / receivable by the company in respect of costs incurred have been disclosed to you and reduced from such costs.

INFORMATION PROVIDED

15. We have provided you with -
 - a) Access to all information of which we are aware that is relevant to the preparation of cost statements including cost records, documentation and other matters.
 - b) Additional information that you have requested for the purpose of this audit.
 - c) Unrestricted access to persons within the company from whom you determined it necessary to obtain audit evidence.
 - d) All particulars relating to utilization of material, labour and other items of cost relating to the products under cost audit have been recorded in the cost records and are reflected in the cost statements.

DISCLOSURES MADE

16. We have disclosed to you -
 - a) All known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing cost statements.
 - b) Details of all legal cases or other disputes pending, which would give rise to any costs other than those which have been disclosed in the cost statements and all demands made by the authorities not accepted by the company, assessments under dispute and pending litigations.
 - c) All information in relation to fraud or suspected fraud that we are aware of & that may affect the company and irrespective whether it involves management, employees, or others where the fraud could have a material effect on the cost statements.
 - d) The results of assessment of the risk that the cost statements may be materially misstated as a result of fraud.
 - e) All irregularities involving management or employees who have a significant role in the system of internal control that could have a material effect on the cost records & cost statements.



- f) The identity of company's related parties and all the related party relationships and transactions with them of which we are aware.
- g) All documentary evidence in support of the bases adopted to determine the normal price in respect of related party transactions and inter-unit or inter-company transfers.

ADEQUACY OF SYSTEMS

- 17. We have provided you with complete documentation on the cost system presently deployed in the company and access to the database for querying and to generate reports.
- 18. There are no persistent deficiencies in the cost accounting system pointed out in earlier cost audit reports but not rectified.
- 19. We have provided you with access to the working of the budgeting process, significant assumptions made in the preparation of budgets, budget documents, control reports and action taken on variances from budget.
- 20. The internal audit of financial accounts and cost accounting records for the year under audit has been carried out and you have been provided with the terms of engagement of the internal auditor, the internal audit plan, the internal audit reports and other communications from the internal auditor.

For_____ Ltd.

Name:

Designation:

** Strike out the words/sentences/para not applicable.*



GLOSSARY TO THE STANDARDS ON COST AUDITING

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.

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.

Arm's length transaction: A transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and reacting independently of each other and pursuing their own best interest.

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 misstatement that may occur.

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.

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.

Audit file: Audit file means one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific Assignment or audit.

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

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

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

(1) **Inherent risk:** the susceptibility of an assertion about the measurement, assignment, or disclosure of cost to a misstatement that could be material, either



individually or when aggregated with other misstatements, before consideration of any related controls.

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

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

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

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

Audit working papers: Audit working papers are the documents which record all audit evidence obtained during audit. Such documents are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the relevant Standards on Cost Auditing.

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

Comparative cost statements: Comparative information where amounts and other disclosures for the prior period are included for comparison with the cost statements of the current period but, if audited, are referred to in the cost auditor's opinion. The level of information included in those comparative cost statements is comparable with that of the cost statements of the current period.

Comparative information: The amounts and disclosures included in the cost statements in respect of one or more prior periods in accordance with the applicable cost reporting framework.

Component: means a factory, unit, branch, subsidiary, product or service for which the management prepares cost statements that should be included in the consolidated cost statements of the entity.

Corresponding figures: Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period cost statements.



Cost Accountant: “Cost Accountant” is a cost accountant as defined in clause (b) of subsection (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.

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

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

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 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, produced or provided by an entity during a given period.

Cost Reporting Framework: Cost reporting framework means the framework adopted by the management in preparation of 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.

Cost Statements: Cost Statements, in relation to an entity, includes unit-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 surplus, as per cost accounts and as per financial accounts;
- (v) statement of value addition and distribution of earnings;
- (vi) details of purchases and sales of goods and services with related parties showing transfer price vis-à-vis normal price; and



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

Deficiency in Internal Control: This exists when:

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

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.

Error: An unintentional misstatement in cost statements, including the omission of an amount or a disclosure.

Expert: An individual or organization possessing skill, knowledge, and expertise in a field other than accounting or auditing, whose work in that field is used by the cost auditor to assist in obtaining sufficient appropriate audit evidence.

External Auditor: means statutory financial auditor or any other auditor, other than the cost auditor, with responsibility for auditing & reporting on information under any law or regulation, which is used by the cost auditor.

External Confirmation: Audit evidence obtained as a direct written response either to the management or to the cost auditor from a third party (the confirming party), in paper form, or by electronic or other medium.

Firm: Firm means a sole practitioner, partnership including LLP (Limited Liability Partnership) or any other entity of professional cost accountants as may be permitted by law and constituted under The Cost and Works Accountants Act & Regulations, 1959.

Fraud: An intentional act by one or more individuals among management, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

Fraud risk factors: Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

General purpose cost statements: Cost statements prepared in accordance with a general-purpose framework.

General purpose framework: A cost reporting framework designed to meet the common cost information needs of a wide range of users. The cost reporting framework may be a fair presentation framework or a compliance framework.



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).

Internal Audit: Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an entity's operations. It helps the entity accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal Auditors: Those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.

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

Lead cost auditor: Lead cost auditor means the cost auditor with responsibility for reporting on the cost statements of an entity that includes the cost statements of one or more components audited by another cost auditor.

Management: The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes those charged with governance.

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.

Misstatement of fact: Other information that is unrelated to matters appearing in the audited cost statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing audited cost statements.

Modified opinion: A qualified opinion, an adverse opinion or a disclaimer of opinion.

Non-compliance: Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations governing cost accounting, cost records and cost audit. It does not include personal misconduct (unrelated to the business activities of the entity) by management or employees of the entity.

Non-sampling risk: The risk that the cost auditor reaches an erroneous conclusion for any reason not related to sampling risk.



For example: Non-sampling risk includes use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation.

Normal Price: Normal Price means price charged for comparable and similar products in the ordinary course of trade and commerce where the price charged in the sole consideration of sale and such sale is not made to a related party. Normal price can be construed to be a price at which two unrelated and non-desperate parties would agree to a transaction and where such transaction is not clouded due to the proximity of the parties to the transaction and free from influence though the parties may have shared interest.

Other information: Cost and non-cost information (other than the cost statements and the auditor's report thereon) which is included, either by law, regulation or custom, in a document containing audited cost statements and the cost auditor's report thereon.

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

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

Pervasive: A term used, in the context of misstatements, to describe the effects on the cost statements that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the cost statements are those that in the cost auditor's judgment are fundamental to users' understanding of the cost statements.

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

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.

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

Professional 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.

Related Party: A related party as defined in the applicable law and regulations or as defined in the applicable cost reporting framework.



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.

Risk Assessment Procedure: The audit procedures performed to identify and assess the risks of material misstatement, whether due to fraud or error, at the cost statement level and at the assertion levels.

Sampling risk: The risk that the cost auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.

Sampling Unit: The individual items constituting a population. The sampling unit might be physical item or monetary units.

Significant Deficiencies in Internal Control: A deficiency or combination of deficiencies in internal control that, in the cost auditor's professional judgment, is of sufficient importance to merit the attention of management.

Significant risk: An identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

Special purpose cost statements: Cost statements prepared in accordance with a special purpose framework.

Special purpose framework: A cost reporting framework designed to meet the cost information needs of specific users. The cost reporting framework may be a fair presentation framework or a compliance framework.

Statistical Sampling: An approach to random selection of the sample item.

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

Substantive procedure: Substantive procedures are intended to create evidence that the cost auditor assembles to support the assertion that there are no material misstatements regarding completeness, validity, and accuracy of the cost records of an entity. It comprises of tests of details, and substantive analytical procedures.

Subsequent events: Events occurring between the date of the cost statements and the date of the cost auditor's report, and facts that become known to the cost auditor after the date of the cost auditor's report.

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.



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.

Unmodified opinion: The opinion expressed by the cost auditor when he concludes that the cost statements are prepared, in all material respects, in accordance with the applicable cost reporting framework.

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.
