



Frequently Asked Questions (FAQs) On Standards on Cost Auditing (SCAs) 101 - 104

SCA-101 on 'Planning an audit of Cost Statements'

1. What are the key considerations in developing "Overall Audit Strategy"?

In establishing the overall audit strategy, the cost auditor shall:

- (a) Identify the characteristics of the engagement that define its scope and reporting objectives of the engagement;
- (b) Plan the timing of the audit of cost statements and the nature of the communications required;
- (c) Consider the factors that, in the cost auditor's professional judgement, are significant in directing the audit team's efforts;
- (d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the audit partner for the entity is relevant; and
- (e) Ascertain the nature, timing and extent of resources necessary to perform the engagement.

2. What are the benefits of establishing Overall Audit Strategy and developing Audit Plan?

Key benefits of audit planning and audit strategy are that it enables a cost auditor to:

- (i) Properly manage and organize the cost audit engagement;
- (ii) Obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud or error.
- (iii) Depute his / her resources in an optimum manner and devise his / her audit schedule as well as methodology such as extent of checking etc. accordingly.
- (iv) Accomplish the audit objectives and determine 'which', 'how much' and 'when' aspects of the resource utilization viz., engagement team;
- (v) Complete the audit in a time bound manner.

3. What are the factors to be considered mandatory while planning a cost audit?

The Cost Auditor shall consider the following factors while planning a cost audit:

- Results of preliminary activities;



- Knowledge from previous audits and other engagements with the auditee;
- Knowledge of business and processes, units to be covered;
- Nature and scope of the audit;
- Statutory deadlines and reporting format;
- Recent changes in the regulations;
- Relevant factors determining the direction of the audit efforts;
- Nature, timing and extent of resources required for the audit.

In addition to the above, the following shall also be considered by the cost auditor:

- The cost reporting framework under the Companies Act and Rules or any other industry specific laws as applicable, on the basis of which the cost information is to be audited;
- Industry regulators' requirement as to how costs will be handled;
- Unique features of an industry that influence audit requirements such as definition of product in the newspaper industry;
- Reliance that can be placed on the work of financial auditors, secretarial auditors, other cost auditors appointed by the entity and internal auditors;
- State of IT (Information Technology) implementation and the reliance that can be placed on them;
- Statutory timelines for cost reporting, which can be modified by the management for early completion;
- Timelines for Board/ audit committee meetings, which can set the time limits for completion of audit work;
- Resources required and available in terms of manpower, equipment and others and the assignment of these to specific parts of the work.

SCA-102 on Cost Audit Documentation

4. What is the meaning of "significant matters" in connection with an audit of cost statements as referred to in the SCAs?

Under Cost Auditing Standard 102 "*Significant Matters*" refer to such matters that give rise to significant risks of a material misstatement. This causes a revision of the Cost Auditor's previous assessment of the risks of material misstatement.

For example the Cost Auditor may have reached a certain conclusion regarding the misstatement of the Material Cost in a Cost statement based on the availability of a well-documented Bill of Materials but his assessment of risk may undergo a change if he finds that there is considerable use of substitute and alternate materials in the actual



production process. Matters that cause the Cost Auditor significant difficulty in applying necessary audit procedures are also significant, as for example heaps of bulk material in irregular shapes which make volumetric measurement of stock in a physical stock taking unreliable.

The Cost Auditor needs to exercise his professional judgement in determining the significant matters and their impact on cost statements to warrant their inclusion in the documentation.

5. What are “exceptional circumstances” referred to in SCA-102?

“Exceptional Circumstances” refers to the facts or matters which become known to the Cost Auditor after the date of the audit report but which existed at that date and which, if known earlier might have caused the cost statements to be amended or the cost audit report to be modified.

Few examples of “Exceptional Circumstances” that if known on or before the date of the audit report might have caused the cost statements to be amended or the cost audit report to be modified.

- ❖ Report on re-assessment of installed capacities issued by the Regulatory Authority;
- ❖ Rejection of few shipments/deliveries by clients relating to year under audit, known after the date of audit report;
- ❖ Retrospective Revision in power tariff rates by the Regulatory Commission;
- ❖ Back-date effect of certain changes made in labour laws/ regulations; or
- ❖ Legal proceedings filed by few overseas suppliers/clients; court orders received after the date of audit report.

6. What is “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.

The Cost Audit documentation will usually contain:

(a) Checklists

Example: Checklist of compliance with:-

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



- (2) The Cost Accounting Standards (CAS) and Guidance Notes as prescribed by the Institute
- (3) The Generally Accepted Cost Accounting Principles (GACAP) as prescribed by the Institute

(b) Audit programs:

Example: Audit Program for Material Cost, Employee Cost and others

(c) Analysis

Cost Audit relies more on analytical review than on substantive testing to establish true and fair view.

Example: Calorific value of different fuels used and average Cost per unit of calorific value and Specific Heat Consumption.

(d) Audit Query List

A log of audit queries raised and their resolution

(e) Abstracts of significant contracts relating to the cost audit

Example: Supply of materials indicating price, quality terms, O&M contracts, Terms of supply of contract labour and others

(f) Letters of confirmation

Example: Stock of materials with subcontractors.

(g) Letter of Representation from Management Correspondence (including e-mail) concerning significant matters.

Example: Correspondence regarding terms of supply of goods and services.

(h) Abstract or copies of the entity's records.

(i) Minutes of the meetings with the auditee

(j) Resolutions pertaining to the related parties

(k) Various reconciliation statements including GST

7. What is meant by "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.

8. Who is the owner of the audit documentation?



The audit documentation is the property of the Cost Auditor. Unless otherwise specified by law or regulation, he may at his discretion, make portions of, or extracts from audit documentation available to the client.

9. What is the nature and purpose of audit documentation?

The nature of audit documentation should be such that meets the requirement of Standards on Cost Auditing issued by the Institute and is enable to provide:

- a) Evidence of the cost auditor's basis for a conclusion about the achievement of the overall objectives of the audit: and
- b) Evidence that the audit was planned and performed in accordance with Standards on Cost Auditing (SCAs) and applicable legal and regulatory requirements.

The purpose of audit documentation is to enable another competent person, having no previous connection with the audit, including person undertaking peer review, to understand that the cost audit conforms and has been performed as per legal and regulatory requirements prescribed in the cost reporting frame work for obtaining sufficient appropriate audit evidence to draw reasonable conclusions on which to base the cost auditor's opinion.

10. What would be the form, content and extent of Audit Documentation? What are the influential factors for the form, content and extent of audit documentation?

The Cost Auditor shall prepare audit documentation that is sufficient to enable another competent person, having no previous connection with the said audit, including person undertaking peer review to understand:

- The nature, timing, and extent of the audit procedures performed to comply with the SCAs and applicable legal and regulatory requirements;
- The results of the audit procedures performed, and the audit evidence obtained;
- Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

The influential factors for the form, content and extent of cost audit documentation depend on factors such as:

- The size and complexity of the entity and its environment.
- The nature of the audit procedures to be performed.
- The identified risks of material misstatement in cost statements as a whole.



- The significance as well as relevance of the audit evidence obtained during cost audit.
- The nature & extent of departure from Cost Accounting Standards or GACAP
- The nature and extent of exceptions identified on case to case basis.
- The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- The cost audit methodology and audit tools used.

11. What is the effect of absence of audit documentation as required by SCA?

If audit documentation does not exist for a particular procedure or conclusion related to a significant matter, it casts doubt as to whether the necessary work was done. If the work is not documented, then it becomes difficult for the audit team, and others, to know what was done, what conclusions were reached, and how those conclusions were reached. Thus sufficient and appropriate audit documentation is extremely important to justify at any competent authority.

12. What is the period for which a cost auditor is required to retain audit documentation?

The Standard on Cost Audit (SCA-102) prescribes that the Cost Audit Documentation should be retained for at least ten years from the date of the Cost Audit Report.

However, Section 128 (5) of the Companies Act 2013 prescribes that the books of account of every company together with the vouchers relevant to any entry in such books of account shall be kept in good order of not less than eight financial years immediately preceding a financial year.

This Section also provides that where an investigation has been initiated in respect of the company, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.

SCA-103 on Overall objectives of the independent cost auditor

13. What is meant by professional ethics?

The professionals are required to comply with relevant ethical requirements as per Code of Ethics issued by the Institute of Cost Accountants of India. This Code of Ethics establishes fundamental principles of professional ethics relevant to the auditor while conducting an audit and provides a conceptual framework for applying these principles. The fundamental principles with which the auditor is required to comply are



Independence, Integrity, Objectivity, Professional competence and due care, Confidentiality and Professional conduct, which are explained below:

a) Independence

A cost accountant's independence is his ability to form an opinion without being affected by the influences that might compromise that opinion.

b) Integrity

A cost accountant should be straightforward and honest in performing his professional services and business relationships.

c) Objectivity

A cost accountant should be fair and should not allow conflict of interest, prejudice or bias or any undue influence of others to override professional judgements.

d) Competence

A cost accountant should maintain updated professional knowledge and skill and ensure that a client receives competent professional service based on current developments in practice, techniques and prevailing laws and regulations. He should act diligently and in accordance with applicable professional standards and technical guides when rendering professional services.

e) Confidentiality

A cost accountant should not disclose to third parties any confidential information acquired as a result of professional and business relationships, without proper and specific authority, unless there is a legal or professional right or duty to disclose. He should also not use such information for personal advantage of himself or third parties.

f) Professional Behaviour

A cost accountant should act in a manner consistent with the good reputation of the profession, comply with relevant laws and regulations and should avoid any action that discredits the profession.

14. Is a cost auditor required to audit the disclosures of Cost Statements?

The cost auditor is required to obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud or error and to enable the auditor to express an opinion whether the Cost Statements are prepared, in all material respects, in accordance with the applicable Cost reporting framework, Cost Accounting Standards (CAS) and Generally Accepted Cost Accounting Principles (GACAP) as issued by the Institute, and give a true and fair view of the Cost of a product, activity or service. The Cost Accounting Standards issued by the Institute



require that the cost statements shall disclose inter-alia any change in the cost accounting principles and methods applied for the measurement and assignment of the cost items during the period covered by the cost statement which has a material effect on the costs. In view of this, the cost auditor is required to audit the disclosure of cost statements.

15. What is meant by “Professional Skepticism”? How does a cost auditor apply Professional Skepticism with Due Professional Care?

Attitude of professional skepticism means a critical assessment, with a questioning mind, of the validity of audit evidence obtained and being alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance.

While professional skepticism is important in all aspects of cost audit, it is particularly important in those areas of the audit that involve significant management judgments or transactions outside the normal course of business. Professional skepticism is also important as it relates to the cost auditor's consideration of fraud in an audit. When cost auditors do not appropriately apply professional skepticism, they may not obtain sufficient appropriate evidence to support their opinions or may not identify or address situations in which the cost statements are materially misstated.

The cost auditor should be careful and not be satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the cost auditor's opinion.

16. What are the major impediments to the application of Professional Skepticism?

The cost auditors may confront the following types of impediments in exercising professional skepticism:

- Human biases and other circumstances can cause cost auditors to gather, evaluate, rationalize, and recall information in a way that is consistent with cost reporting framework.
- Scheduling and workload may lead cost auditors to seek audit evidence that is easier to obtain rather than evidence that is more relevant and reliable but is time consuming and challenging to obtain.



- Other areas including:
 - ✓ avoiding significant conflicts with management;
 - ✓ providing an unqualified audit opinion by a deadline;
 - ✓ achieving high client satisfaction ratings;
 - ✓ keeping audit costs low;
 - ✓ building or maintaining a long-term audit engagement;
 - ✓ Lack of pre-audit planning;
 - ✓ Lack of domain knowledge;
 - ✓ Lack of skills required to understand the relevant technology; or
 - ✓ Lack of skills/ competencies etc.

17. What gives rise to a threat to an auditor's independence and objectivity and how can those threats be managed?

Independence of a cost auditor can be compromised due to existence of self-interest, self-review, holding position of advocacy, over-familiarity, professional insecurity or intimidation. Actual threats need to be considered, and situations that might be perceived as threats by a reasonable and informed observer.

Where such threats exist, the cost auditor must put in place safeguards that eliminate them or reduce them to clearly insignificant levels. Safeguards apply at three levels: safeguards in the work environment, safeguards that increase the risk of detection, and specific safeguards to deal with particular cases.

The cost auditor should ensure that all the safeguards are in place before taking up the assignment.

18. What documentation is required to show compliance to independence requirements of cost auditor?

A cost auditor is to document the following to show the compliance to independence requirements:

- (i) That relevant ethical requirement as per Code of Ethics issued by the Institute of Cost Accountants of India has been complied with.
- (ii) The cost audit is carried out as per the provisions of the Company Law; document to show that qualification criteria provided in the Law is satisfied.
- (iii) Document that shows that the Cost Auditor has not rendered any service that he cannot render by virtue of holding office as a cost auditor, either directly or indirectly to the company or its holding company or subsidiary company.



19. In what manner should a cost auditor maintain and preserve the audit documentation?

Audit documentation should be maintained in a file including in electronic form. The audit documentation must be assembled as the audit goes on. The final audit documentation file should be completed within a reasonable time after the completion of the audit and the cost auditor should not delete or discard audit documentation of any nature before the end of its retention period.

20. What are assertions in the cost statement?

The term 'assertion' means what management have asserted to be true. Audit Assertions are the implicit or explicit claims and representations made by the management responsible for the preparation of cost statements regarding the appropriateness and correctness of the various elements of cost statements and disclosures. Types are:

- **Occurrence** - Costs recognized in the cost statements have occurred and relate to the entity.
- **Completeness** - All costs that were supposed to be recorded have been recognized in the cost statements.
- **Accuracy** - Costs have been recorded accurately at their appropriate amounts.
- **Cut-off** - Costs have been recognized in the correct accounting periods.
- **Measurement** - Costs have been correctly measured as per the applicable Cost Accounting Standards.

21. What is meant by "risk at assertion level" in an audit of cost statements?

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

During their risk assessment, the cost auditor will identify key areas (items of cost, cost heads and disclosures) that are susceptible to the significant risk of material misstatement. The cost auditor will consider 'inherent' and 'control' risk.

Significant risks are those risks that require the cost auditor to give special attention. The following are some of the indicators that a risk could be classified as significant:



- ❖ Risk of fraud;
- ❖ A large degree of subjectivity in the cost information;
- ❖ Transactions that are of an unusual nature;
- ❖ Significant transactions are undertaken with a related party;
- ❖ Transactions undertaken are of a complex nature;
- ❖ Continuance with the obsolete technology or loss making product;
- ❖ Developing or offering new products or services, or moving into new lines of business;
- ❖ Expanding into new locations;
- ❖ Changes in the entity such as large acquisitions or reorganizations or other unusual events;
- ❖ Entities or business segments likely to be sold or plant and facilities likely to be leased;
- ❖ The existence of complex alliances and joint ventures;
- ❖ Deficiencies in internal control, especially those not addressed by management;
- ❖ Cost measurements that involve complex processes; or
- ❖ Events or transactions that involve significant measurement uncertainty, including cost accounting estimates.

22. What factors does a cost auditor take into consideration when performing a risk assessment on their client?

Factors that are taken into consideration by the cost auditor while performing a risk assessment shall include the following:-

- (a) Inquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others within the entity who in the cost auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.
- (b) Analytical procedures performed by the Cost Auditor.
- (c) Observation and inspection made by the Cost Auditor.

Further, the cost auditor shall obtain an understanding of whether the entity has a process for:

- (a) Identifying business risks relevant to cost reporting objectives;
- (b) Estimating the significance of the risks;
- (c) Assessing the likelihood of their occurrence; and
- (d) Deciding about actions to address those risks.



If there is such a risk, the cost auditor shall obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or determine if there is a significant deficiency in internal control with regard to the entity's risk assessment process.

23. In what circumstances cost auditor does the revision of risk assessment?

The cost auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. The cost auditor shall revise the assessment and modify the planned audit procedures accordingly.

SCA-104 on Knowledge of business, its processes and the business environment

24. How can cost auditor gather knowledge about entity and its environment?

The cost auditor should refer to all the possible resources and materials to gather knowledge about the entity and its environment.

Some ways to get the general information about the entity:

- Annual Report of the entity
- Process Study
- Plant Visits
- Supply Chain
- Company's website
- Discussion with management and HODs to have a basic understanding of the Business, strategies as well as operational aspects

Some ways to get the information about the economic environment of the entity:

- Annual Report of Competitor/s
- Internet
- Newspapers
- Journals
- Relevant Ministerial reports
- Reports of Centre for Monitoring Indian Economy (CMIE)
- Research Papers Published etc.

These are the FAQs on SCAs 101 – 104. The CAASB will issue FAQs on further SCAs as and when the SCAs are approved by the Central Government.