



**Draft CAAS - 103**  
**Cost Audit and Assurance Standard on**  
**Overall Objectives of the Independent Cost Auditor and the Conduct of an**  
**Audit in Accordance with Standards on Auditing**

The following is the Exposure Draft of **Cost Audit and Assurance Standard (CAAS 103)** on **“Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”**. In this Standard, the standard portions have been set in bold italic type. This Standard should be read in the context of the background material, which has been set in normal type.

**1. Introduction**

This Standard on Auditing deals with the overall objectives of the independent cost auditor, the nature and scope of a Cost audit the independent auditor’s overall responsibilities when conducting an audit of cost statements in accordance with CAASs. It also explains the scope, authority and structure of the CAASs, and includes requirements establishing the general responsibilities of the independent auditor applicable in all audits, including the obligation to comply with the CAASs.

The independent auditor is referred to as “the Cost auditor” hereafter

**2. Objectives**

The objective of issuing this Standard is to lay down the general principles and broad guidelines governing the Audit of Cost Statements.

The objective of an audit of Cost Statements is to enable the auditor to express an opinion whether the Cost Statements are prepared, in all material respects, in accordance with an applicable Cost reporting framework and give a true and fair view of the Cost of a product, activity or service. In the case of a Cost Audit under the Cost Audit Report Rules in India, the objective is to express an opinion on whether the Cost Statements subject to audit represent a true and fair view of the Cost of production, cost of sales and margin of products covered by the Cost Audit.

It is the responsibility of the management and where required of the governing body e.g. Board of Directors to maintain the cost records, prepare the cost statements and the abridged Cost Statement and other information contained in the Annexure to the Cost Audit Report prescribed by law in India. The Cost Auditor expresses an opinion on them. The CAASs do not in any way alter this responsibility of the management or the governing body.

As part of their responsibility for the preparation and presentation of the cost statements, management and, where appropriate, those charged with governance are responsible for:



- ♦ The identification of the applicable cost reporting framework, in the context of any relevant laws or regulations.
- ♦ The preparation and presentation of the cost statements in accordance with that framework.
- ♦ An adequate description of that framework in the cost statements.

To be in a position to express an opinion, the Cost auditor 's objectives are:

1. to obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud or error, and
2. to report on the cost statements in the form required by law or by the CAAS.in accordance with the auditor's findings.

Where reasonable assurance cannot be obtained, the cost Auditor should qualify the opinion and in extreme cases disclaim an opinion.

The objective may extend to making observations and suggestions where required by regulations e.g. Cost Audit Report Rules.

### 3. Scope

This Standard should be applied while undertaking audit of Cost Statements that require attestation. It also describes management responsibility for the preparation and presentation of the Cost Statement, to identify the Cost Reporting framework and to lay down Cost Accounting policies

The cost reporting framework may be laid down by law e.g. the Cost Audit Report Rules under the Companies Act in India or by the intended user e.g Excise Department in the case of a Section 14AA audit or by a professional body having jurisdiction over the area of reporting.

### 4. Definitions

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

**4.1 Audit:** An audit is an independent examination of financial, cost and other related information of an entity whether profit oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

**4.2 Auditee:** Auditee means a company or any other entity for which cost audit and/ or certification is carried out.



**4.3 Auditor:** Auditor is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable the firm. Auditor includes Cost Auditor

**4.4 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. The risk of material misstatement has two components viz. Inherent Risk and Control risk.

a. 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.

b. 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.

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.

**4.5 Assurance engagement –** An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria.

There are two types of assurance engagements a practitioner is permitted to perform: a reasonable assurance engagement and a limited assurance engagement.

**Reasonable assurance engagement –** The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the practitioner's conclusion.

**Limited assurance engagement –** The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion.



**4.6 Assurance Engagement Risk:** *The risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated.*

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

**4.8 Cost Audit:** Cost audit is an independent examination of cost and other related information in respect of a product or group of products of an entity whether profit oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

**4.9 Cost Auditor:** *“Cost Auditor” means an auditor appointed to conduct an audit of cost records, under sub-section (2) of section 233B of the Companies Act and shall be a cost accountant within the meaning of The Cost and Works Accountants Act 1959. “Cost Accountant” is a cost accountant as defined in clause (b) of sub-section (1) of section 2 of The Cost and Works Accountants Act, 1959 (23 of 1959) and who holds a valid certificate of practice under subsection (1) of section 6 and who is deemed to be in practice under subsection (2) of section 2 of that Act and includes a firm of cost accountants.*

**4.10 Engagement Partner:** *Engagement partner means the partner or other person in the firm who is a member of the Institute of Cost Accountants of India and is in full time practice and is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.*

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

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

**4.13 Misstatement:** *A difference between the amount, 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.*

Where the cost auditor expresses an opinion on whether the cost statements give a true and fair view, misstatements also include those adjustments of amounts, classifications,



presentation, or disclosures that, in the cost auditor's judgment, are necessary for the cost statements to be presented fairly, in all material respects, or to give a true and fair view.

**4.14 Risk Assessment:** *Risk Assessment is the overall process of risk analysis and risk evaluation.*

**4.15 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 Audit. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.

## **5. Requirements**

**5.1** *The cost auditor should comply with the relevant ethical requirements including those pertaining to independence in respect of cost audit engagements.(refer 6.1)*

**5.2** *The cost auditor should comply with Cost Audit and Assurance Standards and Statement on Generally Accepted Cost Audit and Assurance Principles and Practices (GACAAP) while conducting an audit. (refer 6.2)*

**5.3** *In determining the audit procedures to be performed in conducting an audit the cost auditor should comply with each of the Cost Audit and Assurance Standards and also with the Statement on Generally Accepted Cost Audit and Assurance Principles and Practices (GACAAP) relevant to the audit. (refer 6.2) A CAAS is relevant to the audit when the CAAS is in effect and the circumstances addressed by the CAAS exist.*

**5.4** *The cost auditor should not represent compliance unless the auditor has complied fully with all of the Cost Audit and Assurance Standards and Statement on Generally Accepted Cost Audit and Assurance Principles and Practices (GACAAP) relevant to the audit. (refer 6.2)*

**5.5** *The cost auditor should 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. (refer 6.3)*

**5.6** *The cost auditor should exercise professional judgment in planning and performing the audit. (refer 6.4)*



**5.7** *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. (refer 6.4)*

**5.8** *The cost auditor should determine whether the Cost Reporting Framework adopted by management in preparing the Cost Statements is acceptable. (refer 6.5)*

**5.9** *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. (refer 6.6)*

## **6. Application Guidance:**

**6.1 Audit and Ethics(refer 5.1)** : The cost auditor should comply with relevant ethical requirements as per Code of Ethics of the Institute of Cost Accountants of India. This code establishes fundamental principles of professional ethics relevant to the auditor when conducting an audit and provides a conceptual framework for applying these principles. The fundamental principles with which the auditor is required to comply are Integrity, Objectivity, Professional competence and due care, Confidentiality, and Professional behavior. In case an audit engagement is in public interest, then the auditor should be independent of the entity subject to the audit. The cost auditors independence from the entity safeguards the cost auditors ability to form an opinion without being affected by influences that might compromise that opinion.

The provision of services for maintenance of cost records, design and implementation of Cost Systems and internal audit are considered to erode the independence.

## **6.2 Conduct of audit : (refer 5.2, 5.3 and 5.4)**

**6.2.1** The Cost Audit and Assurance Standard and Statement on Generally Accepted Cost Audit and Assurance Principles and Practices provide the standards for the cost auditor's work in fulfilling the overall objectives of the cost auditor. The CAAS AND GACAAP deal with general responsibilities of the cost auditor, as well as cost auditor's further considerations relevant to the application of those responsibilities to specific topics. In performing an audit, the cost auditor may be required to comply with legal or regulatory requirements in addition to CAAS AND GACAAPs.

**6.2.2** The CAAS AND GACAAPs do not override law or regulation that govern audit process. The cost auditor may also conduct the audit in accordance with both CAAS AND GACAAPs and legislative and regulatory requirements. In such cases in addition to complying with each of the CAAS and GACAAP relevant to the cost audit, it may be necessary for the cost auditor to



perform additional audit procedures in order to comply with the legislative and regulatory requirements

The form of the cost auditor's opinion will depend upon the applicable financial reporting framework and any applicable laws or regulations e.g. Cost Audit Report Rules..

**6.2.3** The cost auditor is not expected to represent compliance with Cost Audit and Assurance Standard and Statement on Generally Accepted Cost Audit and Assurance Principles and Practices unless the cost auditor has complied fully with all of the Cost Audit and Assurance Standard and Statement on Generally Accepted Cost Audit and Assurance Principles and Practices .

**6.3 Professional skepticism: (refer 5.5)** 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 be 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. An attitude of professionalism is necessary throughout the cost audit process for the 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. When making inquiries and performing other cost audit procedures, the cost auditor is not 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.

**6.3.1** A cost auditor conducting an audit in accordance with CAAS AND GACAAP obtains reasonable assurance that the Cost Statements taken as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the Cost Statements taken as a whole. Reasonable assurance relates to the whole audit process.

A cost auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the cost auditor's ability to detect material misstatements. These limitations result from factors such as the following:

- The use of testing.
- The inherent limitations of internal control (for example, the possibility of management override or collusion).



- The fact that most audit evidence is persuasive rather than conclusive.

Also, the work undertaken by the cost auditor to form an audit opinion is permeated by judgment, in particular regarding:

- a) The gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and
- b) The drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management in preparing the Cost Statements.

**6.3.2** Further, other limitations may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions. (for example, transactions between related parties). In these cases certain CAAS AND GACAAPs identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:

- a) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or
- b) Any indication that a material misstatement has occurred.

Accordingly, because of the factors described above, an audit is not a guarantee that the Cost Statements are free from material misstatement, because absolute assurance is not attainable. Further, an audit opinion does not assure the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

**6.4 Audit Risk and Materiality:** (refer 5.6 and 5.7) Entities pursue strategies to achieve their objectives, and depending on the nature of their operations and industry, the regulatory environment in which they operate, and their size and complexity, they face a variety of business risks. Management is responsible for identifying such risks and responding to them. However, not all risks relate to the preparation of the Cost Statements. the auditor is ultimately concerned only with risks that may affect the cost statements.

**6.4.1** The cost auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the Cost Statements give a true and fair view or in accordance with the applicable cost reporting framework. The concept of reasonable assurance acknowledges that there is a risk the audit opinion is inappropriate. The risk that the cost auditor expresses an inappropriate audit opinion when the Cost Statements are materially misstated is known as “audit risk.” The cost auditor reduces audit risk by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on





which to base an audit opinion. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level.

**6.4.2** Audit risk is a function of the risk of material misstatement of the cost statements (or simply, the “risk of material misstatement”) (i.e., the risk that the Cost Statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement (“detection risk”). The cost auditor performs audit procedures to assess the risk of material misstatement and seeks to limit detection risk by performing further audit procedures based on that assessment. The audit process involves the exercise of professional judgment in designing the audit approach, through focusing on what can go wrong (i.e., what are the potential misstatements that may arise) at the assertion level and performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence.

**6.4.3** The cost auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the Cost Statements taken as a whole. The cost auditor considers whether the effect of identified uncorrected misstatements, both individually and in the aggregate, is material to the Cost Statements taken as a whole. Materiality and audit risk are related

In order to design audit procedures to determine whether there are misstatements that are material to the cost statements taken as a whole, the cost auditor considers the risk of material misstatement at two levels:

- the overall cost statement level and
- in relation to cost heads, items of cost and disclosures and the related assertions.

**6.4.4** The cost auditor considers the risk of material misstatement at the overall cost statement level, which refers to risks of material misstatement that relate pervasively to the Cost Statements as a whole and potentially affect many assertions. Risks of this nature often relate to the entity’s control environment (although these risks may also relate to other factors, such as declining economic conditions), and are not necessarily risks identifiable with specific assertions at the cost heads, items of cost or disclosure level. Rather, this overall risk represents circumstances that increase the risk that there could be material misstatements in any number of different assertions, for example, through management override of internal control. Such risks may be especially relevant to the cost auditor’s consideration of the risk of material misstatement arising from fraud. The auditor’s response to the assessed risk of material misstatement at the overall cost statement level includes consideration of the knowledge, skill, and ability of personnel assigned significant engagement responsibilities, including whether to involve experts; the appropriate levels of supervision;



**6.4.5** The cost auditor also considers the risk of material misstatement at the cost heads, items of cost and disclosure level because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level. The cost auditor seeks to obtain sufficient appropriate audit evidence at the cost heads, items of cost, and disclosure level in such a way that enables the auditor, at the completion of the audit, to express opinion on the Cost Statements taken as a whole at an acceptably low level of cost audit risk. Auditors use various approaches to accomplish that objective. The discussion in the following paragraphs provides an explanation of the components of audit risk.

**6.4.6** The risk of material misstatement at the assertion level consists of two components as follows:

- “Inherent risk” is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls. The risk of such misstatement is greater for some assertions and related cost heads, items of cost and disclosures than for others. For example, complex calculations are more likely to be misstated than simple calculations. Cost heads consisting of amounts derived from cost estimates that are subject to significant measurement uncertainty pose greater risks than do cost heads consisting of relatively routine, factual data.
- External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a cause changes to a manufacturing process rendering the existing classification of variable and fixed costs inappropriate and cause product contribution to be misstated.. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that relate to several or all of the classes of cost heads, items of cost, or disclosures may influence the inherent risk related to a specific assertion. These latter factors include, for example, external market constraints may cause normal capacity as an unreliable basis for determining unit costs.
- “Control risk” is the risk that a misstatement that could occur in an assertion 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 control. That risk is a function of the effectiveness of the design and operation of internal control in achieving the entity’s objectives relevant to preparation of the entity’s Cost Statements. Some control risk will always exist because of the inherent limitations of internal control.



- Inherent risk and control risk are the entity's risks; they exist independently of the audit of the Cost Statements. The auditor is required to assess the risk of material misstatement at the assertion level as a basis for further audit procedures, though that assessment is a judgment, rather than a precise measurement of risk. When the auditor's assessment of the risk of material misstatement includes an expectation of the operating effectiveness of controls, the auditor performs tests of controls to support the risk assessment. The CAAS AND GACAAPs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risk of material misstatement." Although the CAAS AND GACAAPs ordinarily describe a combined assessment of the risk of material misstatement, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risk of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.
- "Detection risk" is the risk that the cost auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other misstatements. Detection risk is a function of the effectiveness of an audit procedure and of its application by the auditor. Detection risk cannot be reduced to zero because the auditor usually does not examine all of cost heads, items of cost, or disclosure and because of other factors. Such other factors include the possibility that an cost auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through adequate planning, proper assignment of personnel to the engagement team, the application of professional skepticism, and supervision and review of the audit work performed.
- Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risk of material misstatement at the assertion level. The greater the risk of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risk of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.

**6.5 Responsibility for the Cost Statements** (refer 5.8) the cost auditor is responsible for forming and expressing an opinion on the Cost Statements.



The term “Cost Statements” refers to a structured representation of the cost information, which ordinarily includes accompanying notes, derived from cost accounting records and intended to communicate an entity’s use of economic resources and the output obtained in accordance with a Cost reporting framework. The term can refer to for example, a cost statement, reconciliation with financial accounts and related explanatory notes.

**6.5.1** The requirements of the Cost reporting framework determine the form and content of the Cost Statements and what constitutes a complete set of Cost Statements. For certain Cost reporting frameworks, a single cost statement as such and the related explanatory notes constitutes a complete set of Cost Statements. For example a Cost Statement under Cost Accounting Standard 4.

**6.5.2** The Cost auditor is not responsible for preparing and presenting the cost statements in accordance with the applicable Cost reporting framework including inter-alia:

- Designing, implementing and maintaining internal control relevant to the preparation and presentation of Cost Statements that are free from material misstatement, whether due to fraud or error;
- Selecting and applying appropriate Cost accounting policies; and
- Making cost estimates that are reasonable in the circumstances.

**6.6 Non-compliance (refer 5.9)** The cost auditor shall request management to provide written representation that all known instances of non-compliance or suspected non-compliance with laws and regulations governing Cost Accounting, Cost Records and Cost Audit have been disclosed to the cost auditor. The representations provide necessary audit evidence about management knowledge of identified or suspected non-compliance with laws and regulations whose effects may have a material effect on the cost statement however, written representation do not provide sufficient audit evidence on their own, and accordingly do not effect the nature and extent of other audit evidence that is to be obtained by the cost auditor.

**7. Effective date:** this Standard to be applied for basic principles governing cost audit for the period commencing on or after-----