

National CMA Practitioners Convention - 2016

**COST ACCOUNTING STANDARDS [CAS]
STANDARDS ON COST AUDITING [SCA]**

B.B.Goyal

**Former Addl. Chief Adviser Cost
Ministry of Finance, Government of India
Presently, Adviser, ICWAI-MARF**

STANDARDS ON COST AUDITING

Difference between Cost Accounting Standards [CAS] and Standards on Cost Auditing [SCA]

- *Cost Accounting is process of identification, classification, measurement, and assignment of costs to various cost objects.*
- Cost Accounting standards are guidelines for the companies that specify the cost accounting treatment for various cost elements, minimum disclosure requirements and ensure the comparability, consistency, and completeness of cost records.
- Three major issues should be considered in understanding the cost accounting standards and methods:
 - Overall standards;
 - Cost accounting methods; and
 - Industry practices.

STANDARDS ON COST AUDITING

- *Cost Audit is an independent examination of cost statements, cost records and other related information of an entity, with a view to express an opinion thereon.*
- Cost auditors conduct an independent assessment of the accuracy and reasonableness of company's cost statements, which are prepared by the management [cost accountants].
- Standards on Cost Auditing provide following guidance to the cost auditor through each step of the audit process.
 - Audit procedures to be followed;
 - Responsibilities of the cost auditor;
 - Cost reporting.

Cost Accountant makes mistakes, and the Cost Auditor finds them.

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**STANDARDS ON COST
AUDITING [SCA]**

STANDARDS ON COST AUDITING

How Standards are formulated?

- Standards are issued by the Cost Audit & Assurance Standards Board under the authority of the Council of the Institute of Cost Accountants of India.
- As per Section 148(3) of the Companies Act 2013, the auditor conducting the cost audit is required to comply with the “***cost auditing standards***”.
- While formulating Standards, CAASB takes into consideration the applicable laws, usage and business environment prevailing in India, relevant provisions of Cost and Works Accountants Act, Rules and Regulations, Code of Professional Ethics, Cost Accounting Standards and other Statements issued by the Institute.

STANDARDS ON COST AUDITING

Composition of the Board

- Six members of the Council of the Institute
- Head, Cost Audit Branch, MCA
- One member nominated by the C&AG
- Two members nominated by Regulatory bodies
- Two eminent members of the Institute in public practice
- Two members representing Industry
- Two members representing Professional Institutes

Note: The Chairman is nominated by the Council of the Institute

STANDARDS ON COST AUDITING

Types of documents issued by the CAASB:

- Standards on Quality Control
- Standards on Auditing
- Standards on Review Assignments
- Standards on Assurance Assignments
- Standards on Related Services
- Guidance Notes
- Technical Guides
- Practice Manuals

Note: If a particular Standard or any part thereof is inconsistent with any law in force, the provisions of the said law prevails.

STANDARDS ON COST AUDITING

Structure of the Standard

- Each Standard generally follows the following structure prescribed by the IAASB of IFAC.
 - *Introduction*
 - *Objectives*
 - *Scope*
 - *Definitions*
 - *Requirements*
 - *Application and other explanatory material*
 - *Effective date*
 - *Statement of modification*

STANDARDS ON COST AUDITING

Procedure for Issue or Revision of Standards, Guidance Notes, Technical Guides, etc:

- Identification of areas
- Study Group develops preliminary draft
- Preliminary draft with inputs from Technical Directorate is considered by the Board
- If approved, issued as Exposure Draft seeking comments of all Stakeholders
- If not approved; sent to study group for revision
- ED is hosted on the website of the Institute and published in Management Accountant
- ED is widely circulated to Regions, Chapters, PPs, Regulatory bodies, Government departments, Professional Institutes, Industry Associations
- ED exposed for a minimum period of 30 days

STANDARDS ON COST AUDITING

Procedure for Issue or Revision of Standards, Guidance Notes, Technical Guides, etc:

- All Comments/Suggestions received alongwith inputs from the Technical Directorate are discussed in the Board
- Each suggestion is either accepted or rejected with reasons recorded
- Draft is modified based on the comments/suggestions by stakeholders
- If substantially modified, again exposed; else approved and sent to Council
- After approval by the Council, SCA is sent to the MCA
- All Standards are again examined by the Committee constituted by MCA
- After MCA approval, issued by the Council for compliance by the members

STANDARDS ON COST AUDITING

Standards already approved by the MCA and effective for audit on or after 11.09.2015

- CAS-101 - *Planning an Audit of Cost Statement*
- CAS-102 - *Cost Audit Documentation*
- CAS-103 - *Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Standards on Auditing*
- CAS-104 - *Knowledge of Business, its Processes and Business Environment*

Note: MCA directed issue of 15 more Standards by March 31, 2016

STANDARDS ON COST AUDITING

Standards approved by the Council of the Institute and sent to MCA:

- *SCA-105 - Agreeing the Terms of Cost Audit Engagements*
- *SCA-106 - Audit Sampling*
- *SCA-107 - Audit Evidence*
- *SCA-108 - Materiality in Planning and Performing Cost Audit*
- *SCA-109 - Cost Auditor's Responsibility Relating to Fraud in an Audit of Cost Statements*
- *SCA-110 - Evaluation of Misstatements identified during the Cost Audit*
- *SCA-111 - Written Representations*

STANDARDS ON COST AUDITING

Standards approved by the Board and sent to the Council of the Institute :

- *SCA-112 - Using the Work of Internal Auditors*
- *SCA-113 - Using the Work of an Auditor's Expert*
- *SCA-114 - Communication with Those Charged with Governance*
- *SCA-115 - Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*
- *SCA-116 - Analytical Procedures*

STANDARDS ON COST AUDITING

Standards under consideration of the Board:

- *ED - Identifying and Assessing the Risks of Material Misstatement*
- *ED - The Cost Auditor's Response to the Assessed Risk*
- *ED - Using the Work of Another Auditor*
- *ED - Related Parties*
- *External Confirmations*
- *Consideration of Laws and Regulations in an Audit of Cost Statements*
- *Audit Considerations relating to an Entity Using a Service Organisation*

STANDARDS ON COST AUDITING

Standards under consideration of the Board:

- *Forming an Opinion and Reporting on Cost Statements*
- *Modifications to the Opinion in the Cost Auditor's Report*
- *The Cost Auditor's Responsibilities Relating to Other Information in Documents containing Audited Cost Statements*
- *Subsequent Events*
- *Special Considerations-Audit of Cost Statements prepared in accordance with Special Purpose Frameworks*
- *Comparative Information-Corresponding Figures and Comparative Cost Statements*

STANDARDS ON COST AUDITING

Important Terms used in the Standards:

- ***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.
- ***Management:*** The person(s) with executive responsibility for the conduct of the entity's operations.
- ***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.

STANDARDS ON COST AUDITING

Important Terms used in the Standards:

- ***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.
- ***Those charged with governance:*** The person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the cost and financial reporting process.
- ***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.

STANDARDS ON COST AUDITING

Important Terms used in the Standards:

- ***Cost Reporting Framework:*** Cost Reporting Framework means the framework adopted by the management and, where appropriate, by those charged with governance, in the preparation of the cost statements that is acceptable in view of the nature of the entity and the objective of the cost report, **or that is required by law or regulation.**
- ***Performance Materiality:*** Performance materiality means the amount or amounts set by cost auditor at less than materiality for the cost statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatement exceeds materiality for the cost statements as whole.
- ***Preconditions for cost audit:*** The use by management of an acceptable cost reporting framework in the preparation of the cost statements and the agreement of management and, where appropriate, those charged with governance to the premise on which cost audit is conducted.

STANDARDS ON COST AUDITING

True and Fair View of Cost Statements - Audit Concept

- **Definition** - True and fair view in auditing means that the cost statements are free from material misstatements and faithfully represent the performance of the entity.
- **Explanation –**
- **True** suggests that the cost statements are factually correct and have been prepared according to applicable reporting framework and they do not contain any material misstatements that may mislead the users.
- **Fair** implies that the cost statements present the information faithfully without any element of bias and they reflect the economic substance of costs rather than just their legal form.

STANDARDS ON COST AUDITING

True and Fair View of Cost Statements - Audit Concept

- **Application & Importance –**
- Preparation of true and fair cost statements has been expressly recognized as one of the responsibilities of the directors of company in the Companies Act, 2013.
- Cost Auditors must therefore consider whether directors have fulfilled their responsibility for the preparation of true and fair cost statements when providing an audit opinion.

STANDARDS ON COST AUDITING

Audit Risk - Inherent Risk, Control Risk & Detection Risk

- **Audit Risk** is the risk that an auditor expresses an inappropriate opinion on the cost statements.

Audit Risk = Inherent Risk x Control Risk x Detection Risk

- **Inherent Risk** is the risk of a material misstatement in the cost statements arising due to error or omission as a result of factors other than the failure of controls.
 - **Control Risk** is the risk of a material misstatement in the cost statements arising due to absence or failure in the operation of relevant controls of the entity.
 - **Detection Risk** is the risk that the auditors fail to detect a material misstatement in the cost statements.
- **Cost auditor must apply audit procedures to detect material misstatements in the cost statements whether due to fraud or error.**

STANDARDS ON COST AUDITING

Assertions in the Audit of Cost Statements

- **Audit Assertions** are the implicit or explicit claims and representations made by the management responsible for the preparation of cost statements regarding the appropriateness 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 Standards.
 - **Classification** - Costs have been classified and presented fairly in the cost statements.
 - **Presentation & Disclosure** - Costs have been correctly disclosed as per the applicable cost reporting framework.

STANDARDS ON COST AUDITING

Application of Assertions

- As part of the risk assessment procedures, auditors are required to understand the entity and its environment including the assessment of the risk of material misstatement (ROMM) due to fraud and error at the cost statement and assertion level.
- The assessment of ROMM at the financial statement and assertion level provides the basis for determining the nature, timing and extent of audit procedures that are necessary to obtain sufficient and appropriate audit evidence in response to those assessed risks.
- Substantive tests are performed to identify material misstatements at the assertion level. In case of assertions whose ROMM has been assessed as significant and no tests of control are planned to be performed, the substantive procedures should include tests of detail.

STANDARDS ON COST AUDITING

Application of Assertions

- Tests of control (TOCs) are performed to assess the operating effectiveness of controls at the cost statement and assertion level. TOCs are necessary to validate the auditor's expectation of the operating effectiveness of controls.
- Auditor shall conclude whether sufficient and appropriate audit evidence has been obtained for all material cost statement assertions taking into account any revisions in the assessment of ROMM at the assertion level.
- Where an auditor is unable to obtain sufficient and appropriate audit evidence in respect of a material cost statement assertion, he is required to modify the audit report accordingly.

STANDARDS ON COST AUDITING

Purpose & Objectives of Auditing Cost Statements

- **Objective** - The objective of external audit is for the auditor to express an opinion on the truth and fairness of cost statements.
- **Accountability** - The main necessity for conducting the audit of cost statements stems from the fact that the persons responsible for the preparation of cost statements are often different from the owners of large corporations.
- **Reliability** - Apart from the needs of owners, other stakeholders that rely on audited cost statements include the following:
 - Tax authorities
 - Regulatory bodies
 - Banks & Financial institutions
 - Management
- **Scope** - Audit is intended to provide a 'reasonable' assurance over the accuracy of cost statements. It does not provide absolute assurance that the cost statements are free from all misstatements. Absolute assurance is impossible to guarantee in most cases due to the inherent limitations of audit.

STANDARDS ON COST AUDITING

Audit Essentials

- Agreeing the Terms of Cost Audit Engagements
- Knowledge of Business, its Processes and Business Environment
- Audit Planning
- Audit Sampling
- Audit Evidence
- Audit Documentation

Audit Procedures

- Management Representation
- Test of Control
- Test of Details
- Substantive Procedures
- Analytical Procedures

STANDARDS ON COST AUDITING

Limitations of Audit of Cost Statements

- Inherent Limitations
- Use of Professional Judgment
- Use of Sampling
- Management Representations
- Risk of Fraud
- Time Constraints
- Independence Threats
- Scope

STANDARDS ON COST AUDITING

Tentative areas of Misstatements in Cost Statements, either due to error or fraud (A)

- Understatement or overstatement of installed capacities
- Misstatement in measurement, classification, allocation, apportionment and absorption of costs
- Misstatement of costs with a view to claim higher subsidies or evade taxes or due to error
- Over-valuation or under-valuation of inventory either due to error or with a view to manipulate profits and taxes
- Wrong consumption of raw materials, utilities and other inputs resulting in misstatement in cost of production
- Misstatement in production and sales records to evade taxes
- Wrongful recognition of revenues
- Wrong classification of joint-products or by-products
- Significant variations in physical inventories vis-a-vis stock statements

STANDARDS ON COST AUDITING

Tentative areas of Misstatements in Cost Statements, either due to error or fraud (B)

- Non or wrong recognition of idle capacities, idle facilities, idle manpower, etc.
- Overstatement or understatement of scrap, defectives, wastages, spoilage, etc.
- Non-recognition of cases of thefts, pilferage, etc., if any
- Recognition of abnormal costs as normal costs or vice versa
- Recognition of non-cost items as costs or vice versa
- Inappropriate traceability of costs to particular cost objects
- Misstatement in arm's length price in relation to transactions with related parties
- Wrong certification of stocks lying with third parties
- Over or under invoicing of purchases or sales

STANDARDS ON COST AUDITING

Tentative areas of Misstatements in Cost Statements, either due to error or fraud (C)

- Recognition of fake bills of purchases of goods and services
- Recognition of costs not actually incurred
- Treatment of capital as revenue or vice-versa
- Booking of fake manpower costs not actually engaged
- Wrongful recognition of group companies' costs or assets
- Recognition of dead or unserviceable stocks as 'good' inventories or vice versa
- Recognition of third party stocks as own stocks or vice versa
- Non-booking of costs already accrued
- Mistatement in quantities and values showing material mismatch with cost estimates

STANDARDS ON COST AUDITING

Tentative areas of Misstatements in Cost Statements, either due to error or fraud (D)

- Treatment of self-manufactured materials, components, sub-assemblies, tools, etc. as purchases
- Valuation of international transactions at wrong forex rates
- Wrongful recognition of subsidies, grants, incentives, etc.
- Recognition of imputed costs
- Recognition of defectives production as good ones or vice versa
- Recognition of semi-finished goods as finished goods or vice versa
- Under or overstating life of assets [or additions to or deletion of assets] resulting in over or undercharging of depreciation or amortization

STANDARDS ON COST AUDITING

Other Issues:

- Exposure Drafts – Comments by Members
- Glossary of Terms used in SCAs
- Guidance Manual for Audit Quality, prepared by the Quality Review Board (QRB) and issued by the Council of the Institute
- Audit Standard to be issued
- Peer Review Board
- Peer Review Guidelines

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**COST ACCOUNTING
STANDARDS [CAS]**

COST ACCOUNTING STANDARDS

Common Issues:

- Authority to issue CAS
- Composition of the CASB
- Broad Structure of CAS
- Guidance Notes on CAS
- Procedure to issue CAS or Guidance Notes
- Glossary of Terms used in CAS
- Compliance provisions
- Exposure Drafts – comments by members

COST ACCOUNTING STANDARDS

| Sno. | CAS No. | Title | Effective |
|------|----------------|---|------------|
| 1 | CAS-1 (R-2015) | Classification of Costs | 01.04.2016 |
| 2 | CAS-2 (R-2015) | Capacity Determination | 01.04.2016 |
| 3 | CAS-3 (R-2015) | Production & Operation Overheads | 01.04.2016 |
| 4 | CAS-4 | Determination of Cost for Captive Consumption | 01.04.2010 |
| 5 | CAS-5 | Determination of Average (Equalized) Cost of Transportation | 01.04.2010 |

COST ACCOUNTING STANDARDS

| Sno. | CAS No. | Title | Effective |
|------|---------|------------------------------|------------|
| 6 | CAS-6 | Material Cost | 01.04.2010 |
| 7 | CAS-7 | Employee Cost | 01.04.2010 |
| 8 | CAS-8 | Cost of Utilities | 01.04.2010 |
| 9 | CAS-9 | Packing Material Cost | 01.04.2010 |
| 10 | CAS-10 | Direct Expenses | 01.04.2010 |
| 11 | CAS-11 | Administrative Overheads | 01.04.2010 |
| 12 | CAS-12 | Repairs & Maintenance Cost | 01.04.2010 |
| 13 | CAS-13 | Cost of Service Cost Centers | 01.04.2011 |
| 14 | CAS-14 | Pollution Control Costs | 01.04.2012 |

COST ACCOUNTING STANDARDS

| Sno. | CAS No. | Title | Effective |
|------|---------|----------------------------------|------------|
| 15 | CAS-15 | Selling & Distribution Overheads | 01.04.2013 |
| 16 | CAS-16 | Depreciation & Amortization | 01.04.2014 |
| 17 | CAS-17 | Interest & Financing Charges | 01.04.2014 |
| 18 | CAS-18 | Research & Development Cost | 01.04.2014 |
| 19 | CAS-19 | Joint Costs | 01.04.2014 |
| 20 | CAS-20 | Royalty & Technical Know-how Fee | 01.04.2014 |
| 21 | CAS-21 | Quality Control Costs | 01.04.2014 |
| 22 | CAS-22 | Manufacturing Costs | 01.04.2015 |

STANDARDS ON COST AUDITING

Documents under different stages before the Board:

- *ED – Treatment of Revenue for Cost Statement*
- *CAS – Determination of Arm's Length Price*
- *CAS – Overburden Removal Cost*
- *GN – CAS-13: Cost of Service Cost Centers*
- *CAS – Recognition of Cost Centers*
- *CAS – Stock Valuation*
- *CAS – Cost of Conversion*
- *CAS – Reconciliation of Cost & Financial Statements*
- *CAS – Return on Capital Employed*
- *CAS – Predatory Pricing*
- *CAS – Prior Period Incomes & Expenses*
- *CAS – Mining Rights*
- *CAS – Accounting of other Non-generating Resources*
- *CAS – Treatment of Discounting Charges*

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**THANKS & NOW YOUR
TURN FOR QUESTIONS**