

WEBINT FOR INSTITUTE OF COST ACCOUNTANTS OF INDIA ON 9TH AUGUST 2020

Requirements of Overall Objectives of the Independent Cost Auditor AND the Conduct of an Audit in Accordance with Cost Auditing Standards - SCA 103

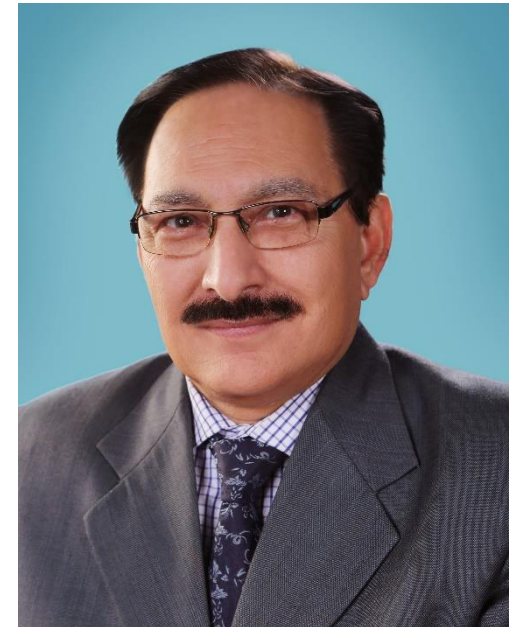
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BRIEF ABOUT CMA J K BUDHIRAJA

- *Fellow Members of The Institute of Cost Accountants of India (ICAI) and The Institute of Company Secretaries of India (ICSI);*
- *Ex-Chief Executive Officer (CEO) of Insolvency Professional Agency of Institute of Cost Accountants of India (IPA ICAI);*
- *Ex-Senior Director (Technical), The Institute of Cost Accountants of India, HQ (Delhi Office), Lodhi Road, New Delhi-110003;*
- *Practiced as Cost Accountant and Registered Insolvency Professional, handled many cases CIRP under IBC 2016 and now Advisor, ICWAI MARF;*
- *Ex-General Manager (Finance)/CFO, Central Electronics Ltd. (CEL);*
- *Ex-Head (Finance)/CFO & Company Secretary, EdCIL (India) Ltd. (PSU). Also worked with National Fertilizers Ltd (NFL)-PSU, Hindustan Fertilizer Corporation Ltd (HFC)-PSU;*
- *Represented CMA Institute in Working Groups 2 & 3, constituted by MCA for drafting Rules and Regulations under IBC 2016;*
- *Ex-Member, Advisory Committee on Corporate Insolvency Process and Liquidation, constituted by Insolvency and Bankruptcy Board of India (IBBI);*
- *Ex-Member, Working Group constituted by IBBI for drafting Rules and Regulations relating to Guarantor Corporate Debtors, and Individuals having Businesses.*

COST AUDITING STANDARDS

- Proviso to Section 148(3) of the Companies Act 2013 stipulates: Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards.
- *Explanation given under Section 148(3) is as follows:*
- **Explanation.**—*For the purposes of this sub-section, the expression “cost auditing standards” mean such standards as are issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.*
- The Central Government vide its letter dated 10th September 2015 approved the following 4 Cost Auditing Standards which came into force with effect from 11th September 2015: [Letter](#)
 1. ***Cost Auditing Standard-101 on Planning an audit of Cost Statements;***
 2. ***Cost Auditing Standard-102 on Cost Audit Documentation;***
 3. ***Cost Auditing Standard-103 on Overall objectives of the independent cost auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards; and***
 4. ***Cost Auditing Standard-104 on Knowledge of business, its processes and the business environment***

Standards on Cost Auditing – Approved by Board

- *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 - Written Representations*
- *SCA-111 - Evaluation of Misstatements identified during the Cost Audit*
- *SCA-112 - Analytical Procedures*
- *SCA-113 - Using the Work of Internal Auditors*
- *SCA-114 - Using the Work of Cost Auditor's Expert*
- *SCA-115 - Communication with Those Charged with Governance*
- *SCA-116 - Communicating Deficiencies in Internal Control to those Charged with Governance and Management*
- *SCA-117 - Identifying and Assessing the Risks of Material Misstatement*
- *SCA-118 - The Cost Auditor's Response to the Assessed Risk*
- *SCA-119 - Related Parties*

STRUCTURE OF STANDARDS ON COST AUDITING

Clauses	Explanation
1. Introduction	Explains subject matter of SCA in brief, and context in which the SCA is set.
2. Objectives	Objectives to be achieved by the cost auditor in complying with the requirements of SCA keeping in mind the interrelationships among other SCAs.
3. Scope	Scope and applicability of SCA keeping in view subject matter & specific expectations from cost auditor and others in the context in which the SCAs are set.
4. Definitions	Description of terminology used in SCA. However, no definition can override the meaning defined in law and regulations.
5. Requirements	Outlines the specific requirements of SCA. Requirements containing the word “shall”, is mandatory (<i>Bold Italic</i>) to be complied with, unless stated otherwise The Non Bold Italic part of this section provide further explanation to relevant requirement.

Structure of Standards on Cost Auditing

SCA Elements	Comments
6. Application Guidance	<p>Provides further explanation of the requirements and guidance for carrying the requirements set out in the SCA.</p> <p>Covers background information, addresses meaning of requirements and explains the requirements precisely with examples wherever required.</p> <p>However, the actual procedures selected by the cost auditor require the use of professional judgment based on the particular circumstances of the entity.</p>
7. Effective Date	Date from which the application of the SCA is mandatory.
8. Statement of Modification	SCAs are formulated based on International Standards on Auditing (ISAs) which primarily focus on financial audit. Due to fundamental differences between the scope and methodology of financial and cost audit, " Statement of Modifications " are issued by the Institute containing comparison to International Auditing Standards.
Annexure / Appendices	Appendices form part of the application and other explanatory material. The purpose and intended use of an appendix/ annexure are explained in the body of the related SCA, or within the title and introduction of the appendix/ annexure itself.

COST AUDITING STANDARDS

- *What is difference between Cost Auditing Standards as mandated under Section 148(3) of the Companies Act 2013 and “Standards on Cost Auditing- SCAs” used by the Institute?*
- *There is no difference between “Standards on Cost Auditing (SCA)” issued by the Institute and “Cost Auditing Standards” referred to in section 148(3) of the Companies Act, 2013, both are to be used interchangeably.*

FLOW OF PRESENTATION

1. To discuss important Definitions contained in SCAs and understanding other important terms used in other SCAs
2. To discuss Advisory issued by CAASB on 10th June 2020 in view of COVID-19 and Lockdown situation; What needs to be done by Cost Auditors with relation to **ONLINE/ REMOTE Audit**
3. To discuss Advisory issued by Technical Cell dated 26th June 2020 on **Disclosures in the Audit Report** in light of the Lockdown due to COVID19 Pandemic
4. To discuss briefly on the Requirements of SCA-103;
5. To discuss each of Requirements as given in SCA 103
6. To discuss very briefly what constitutes “**Audit Evidence**” in view of SCA-107
7. To discuss very briefly “**Audit Sampling**” as per SCA-106

FLOW OF PRESENTATION

7. *To discuss briefly on “Types of Audit Procedures”*
8. *To discuss Risk Assessment Procedures (in response to assessed risks)*
9. *To discuss briefly SCA-113: Using the work of Internal Auditor by the Cost Auditor- Extent & Precautions.*
10. *To discuss briefly SCA-110: Written Representation How to get Written representations from management as audit evidence; Desired actions to be taken if management refuses to provide appropriate representations.*
11. *To discuss Illustrative Written Representation which should be taken by a Cost Auditor.*
12. *What types of possible Misstatements can in Cost Statements: Examples of Misstatements in Cost Statements, either due to error or fraud.*

Cost Auditing Standards (SCAs)

- **Objective of Cost Auditor** *is to obtain reasonable assurance* that the cost statements present true and fair view of cost of production/operation, cost of sales, margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis and these are prepared in accordance with the applicable cost reporting framework.
- **True and Fair View of Cost Statements**
- **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.

Cost Auditing Standards (SCAs)

- ***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 cost accountants.***
- Standards on Cost Auditing provide the following guidance to the cost auditor:
 - ***Audit procedures to be followed;***
 - ***Responsibilities of the cost auditor;***
 - ***Cost reporting.***

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

Cost Auditing Standards (SCAs)

- **Important Terms used in the Standards:**

Assertions: *Representations by management, explicit or otherwise, that are embodied in the cost statements, as used by the auditor to consider the different types of potential misstatements that may occur.*

- **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.

Cost Auditing Standards (SCAs)

- Important Terms used in the Standards:

Cost Records : *Cost Records means books of accounts relating to utilization of materials, labour and other items of cost, to facilitate calculation of true and fair cost of production or cost of operations, cost of sales, and margin for each product or service or activity, produced or provided by an entity including a non-profit entity, for any period, in compliance with Cost Accounting Standards issued by the Institute.*

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.

Cost Auditing Standards (SCAs)

- **Important Terms used in the Standards: (Conti...)**

Cost Statements:-Cost Statements, in relation to an entity, includes plant-wise, factory- wise or service centre-wise:

- i) quantitative details of capacity, production , trade purchases, sales and stocks;
- ii) quantitative, rates and value details of consumption of materials, utilities and other inputs;
- iii) cost sheet showing element-wise, total as well as per unit cost of production of goods or provision of services, cost of sales and margin for each product or service;
- iv) reconciliation of profits, or in case of an entity carrying on any activity not for profit, of surplus, as per cost accounts and as per financial accounts;
- v) reconciliation of indirect taxes showing details of total clearance of goods / services, assessable value, duties/ taxes paid, CENVAT or VAT or Service Tax credit utilized, duties / taxes recovered and interest / penalty paid;
- vi) statement of value addition and distribution of earnings;
- vii) details of purchases and sales of goods and services with related parties showing transfer price vis-à-vis normal price; and
- viii) any explanatory note annexed to, or forming part of, any document referred to in (i) to (vii) above.

Cost Auditing Standards (SCAs)

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. Misstatement can arise from error or fraud.

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.*

Cost Auditing Standards (SCAs)

- Important Terms used in the Standards:

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.

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

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.**

Cost Auditing Standards (SCAs)

Audit Risk - Inherent Risk, Control Risk & Detection Risk

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

$$\text{Audit Risk} = \text{Inherent Risk} \times \text{Control Risk} \times \text{Detection Risk}$$

- **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.**

Cost Auditing Standards (SCAs)

Audit Essentials

- ✓ Agreeing the Terms of Cost Audit Engagements [**SCA-105**]
- ✓ Knowledge of Business, its Processes and Business Environment [**SCA-104**]
- ✓ Audit Planning [**SCA-101**]
- ✓ Audit Sampling [**SCA- 106**]
- ✓ Audit Evidence [**SCA- 107**]
- ✓ Audit Documentation [**SCA-102**]

Audit Procedures

- ✓ Management Representation [**SCA- 110**]
- ✓ Test of Control [**SCA- 106 Audit Sampling**]
- ✓ Test of Details **SCA- 106 Audit Sampling and SCA-112 Analytical Procedures**]
- ✓ Substantive Procedures [**SCA-112 Analytical Procedures**]
- ✓ Analytical Procedures [**SCA-112**]

Cost Auditing Standards (SCAs)

SCA-106: Audit Sampling

- **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.*
- **Population:** *The entire set of data from which a sample is selected and **about which the cost auditor wishes to draw conclusions.***
- **Statistical Sampling:** *An approach to sampling that has the following characteristics:*
 - i) *Random selection of the sample item: and*
 - ii) *The use of probability theory to evaluate sample results, including measurement of sampling risk.*

A Sampling approach that does not have characteristic (a) and (b) is considered non-statistical sampling.

Sampling Unit: *The individual items constituting a population.*

The sampling unit might be physical item (**for example**, checks listed on material issue slips, consumption statement entries, sale invoices or inventory balances) or monetary units.

Cost Auditing Standards (SCAs)

SCA-107: Audit Evidence

- **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.**
- **Main Source of Audit Evidence primarily obtained from cost audit procedures performed during the course of the cost audit.** It may, however, also include information obtained from other sources such as previous cost audits **(However, the relevance is to be checked by Cost Auditor).**
- **Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.**
- **In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the cost auditor, and therefore, also constitutes audit evidence.**

Cost Auditing Standards (SCAs)

- **Substantive tests are performed to identify material misstatements at the assertion level. In case of assertions for which Risk of Material Misstatement (ROMM) has been assessed as significant and **then** no tests of control are planned to be performed, the substantive procedures should be performed which include tests of detail.**
- **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 assertions in cost statement taking into account any revisions in the assessment of ROMM at the assertion level.**
- ***Where Cost auditor is unable to obtain sufficient and appropriate audit evidence in respect of a material assertion in cost statement, he is required to modify the cost audit report accordingly.***

Cost Auditing Standards (SCAs)

- **Initial Audit:** Initial audit means an audit where:-
 - a) The entity is subject to audit for the first time, as per the applicable laws, or
 - b) The audit of the entity for the prior period was conducted by a different audit firm.

Substantive procedures are performed by an auditor to detect whether there are any material misstatements in transactions. It comprises of:

- (i) **Tests of details** (of classes of transactions, account balances, and disclosures); and
- (ii) **Substantive analytical procedures.**(Substantive analytical procedures are types of analytical procedures being used as a substantive procedure **to obtain evidence about particular assertions** related to account balances or classes of transactions).

Advisory by CAASB dated 10th June 2020

- Due to outbreak of Novel Corona Virus [COVID 19] Pandemic worldwide and declaration of Lockdown and Travel Restrictions by the Government, have forced the professionals to perform the Audit/ Assurance/ Certification assignments in remote mode taking help of IT enabled techniques.
- However, Cost Audit and Certification requires the cost auditors to visit the office / place of operations of the client to perform his duties effectively and efficiently.
- Thus the process of Remote Audit using IT enabled Techniques shall be adopted by the Cost Auditor only when it is not possible due to restrictions imposed by the Government or considering the situation of Lockdown and Travel Restrictions due to COVID19.

- In order to carry out online assignments successfully, it is essential for the members to enhance his or her skills and capabilities of online working in order to achieve professional success.
- **e-Signatures and UDIN:** Cost Audit Report can be signed by the Member by affixing his/her digital signature. Information Technology Act 2000 permits the use of electronic signature for authentication of documents under prescribed conditions. **UDIN is compulsory for the practicing members of the Institute.**
- **Remote / Online / E Auditing:** COVID-19 crisis has compelled organizations to adapt new ways of doing things including audit of cost records remotely. Worldwide Auditors are allowed to carry out their statutory and other responsibilities through online medium.
- However, our Institute advisory says that members should not undertake those assignments on online mode, which require site visit compulsorily.

- However, the Audit Report that results from a remote audit is no different than the one that results from an onsite audit, and the data and opinions contained therein is equally valid for all the financial Institutions, board members, shareholders, investors and other stakeholders.
- Further, where clients still maintain mostly paper records, accessing client books and records may present hurdles for some auditors in some cases. *Cost Auditors may be able to obtain client-prepared copies or scans of key records.*
- But Cost auditors need to apply professional skepticism while considering the authenticity of those records and they may have to perform additional audit procedures to be satisfied that those records are complete, accurate, and authentic.
- *In cases where cost auditors are unable to access client books and records, they may have to inform clients that audits cannot be completed until books and records can be accessed.*

- Also, shifting to a remote audit may require the professionals to employ some tools and resources that they have not used before, including digital signatures and internal technology tools that enhance ability to exchange and store files securely.
- Remote Audits can successfully be conducted with the help of a good partnership between technology and communication with the clients.
- Detailed audit planning and communication are essential to any audit, but they are more important in remote audits to ensure a smooth workflow.

- Essential of Remote audits are wide range of technology/ Access to ERP system, including email, software applications, audit software, videoconferencing with screen share capability, and secure portals through which clients may upload documentation and notes to the auditors, as well as receive documents from the auditors that need review or signatures.
- So for conducting the Cost Audit remotely, some additional matters are to be included and some may be removed. Also, documentation is also to be done accordingly.

Advisory of by Technical Cell

Advisory by Technical Cell dated 26th June 2020 on Disclosures in the Audit Report in light of the Lockdown due to COVID19 Pandemic

A. Impact of COVID19 Lockdown on the Operations of the Company and Resumption of Operations post COVID19 Lock down

Due to the Lockdown announced by the Central / State Governments the operations of the company were shut down from _____ **(mention the date)** *(if different dates for different plants, please mention individually)*. As per the relaxation offered by the respective Central / State governments and local authorities, **the Company has resumed its operations at various plants in a phased manner since _____ (mention the date) (if different dates for different plants, please mention individually) conforming to the guidelines of the Government.**

Advisory of by Technical Cell

B. Comment on the Physical Visit to the Plants

The nationwide Lockdown process started from 22nd March 2020 in form of a 14 Hr. 'Janata Curfew'. A formal National Lockdown was announced by the Central Government from 24th March 2020 in successive phases. This has resulted into serious restrictions on travel. **Hence there have been limitations on physical visits to the head office / units / plants / branches / offices / etc. of the Company.**

In light of the said travel restrictions, **I/we have visited _____**
(mention the names of the units / plants / branches / offices of the company) / I/we have not visited the Company. (strike whatever not relevant)

Form CRA 3 (Form of the Cost Audit Report) requires Cost Auditor to comment on the adequacy of the data / information / returns received for the purpose of Cost Audit, from the branches not visited by us. I/We would like to mention that due to the Lockdown situation as mentioned above, I/we were not able to visit any / some of the branches of the Company. (strike whatever not relevant) But I/we have received the relevant data / information / record / returns from the branches not visited by us.

Advisory of by Technical Cell

C. Audit using Online Auditing Method / Techniques

In light of the restrictions in physical movement and visits to the company offices, **the Company has given us access to their ERP System**. I/We were able to access the relevant data & records for my/our Audit purpose. Further the company has provided all other data / information / records as required **by us using e-data sharing modes**. **I/We also had continuous communication with the Audit Team & Management of the Company using various modes such as Audio / Video Conferencing, etc.**

In this respect, I/we have followed the 'Advisory on Auditing and Assurance assignments during the Period of Lockdown and Restrictions on Travelling' issued by The Institute of Cost Accountants of India to the extent relevant and applicable.

OR

In light of the restrictions in physical movement and visits to the company offices, **the Company has provided all the data / information / records as required by us for the purpose of my/our Audit using e-data sharing modes**. **I/We also had continuous communication with the Audit Team & Management of the Company using various modes such as Audio / Video Conferencing, etc.**

In this respect, I/we have followed the 'Advisory on Auditing and Assurance assignments during the Period of Lockdown and Restrictions on Travelling' issued by The Institute of Cost Accountants of India to the extent relevant and applicable.

Advisory of by Technical Cell

D. Online Verification of the Document / Records / Statements & Assurance about the accuracy and authenticity of the same

Due to the phase wise Lockdown imposed by Central / State Governments and the resulting travel restrictions, it was not possible to physically visit the Company and carry out the audit function. I/We have carried out the Audit Process using various techniques of Online Auditing. **I/We have verified the records / documents / statements received by us through electronic media. I/We have also received Management Representation Letters where ever necessary. *Using such techniques I/we have ensured reasonable assurance that the information / record / statements provided to us are free from material misstatement and adhere to the relevant standards.***

In this respect, I/we have also followed the 'Advisory on Auditing and Assurance assignments during the Period of Lockdown and Restrictions on Travelling' issued by The Institute of Cost Accountants of India to the extent relevant and applicable.

Advisory of by Technical Cell

E. Physical Inventory Count on a date other than the date of the Financial Statements

Due to the Lockdown imposed by the Central / State Governments in wake of the COVID19 Pandemic, it was not feasible for the Company to carry out a Physical Inventory Count on the date of the Financial Statements, i.e. on 31st March 2020. **The Company has decided to opt for Physical Inventory Count at a date other than the date of Financial Statements.** I/We have / have not attended the Physical Inventory Count in person / through online mode. ***(strike whatever not relevant)*** The Company is following / not following ***(strike whatever not relevant)*** a system of Perpetual Inventory Count. **I/We have followed various Roll Forward Techniques for establishing reasonable authenticity and accuracy of the Physical Inventory Count. I/We have relied upon the records of material movement, purchases, sales, goods receipts, scrap, etc. as made available to us by the management.** I/We have relied on the data / information as certified by the management or certified by other independent auditors, wherever required.

Advisory of by Technical Cell

F. Formation / Expression of Opinion

I/We have carried out the Audit Process using Online Mode. I/We have carried out the Audit Process subject to my/our disclosures as mentioned above. **The audit evidence obtained by us is adequate to express my/our audit opinion.** *While expressing my/our audit opinion, I/we have also relied upon certifications by the management or certifications by other independent auditors, wherever required.*

Roll Forward Techniques

Fixed Asset Roll Forward Technique

- A fixed asset roll forward is a schedule showing the opening balance, additions, disposals, transfers, and closing balance for a particular asset. The account balance can vary among fixed assets. They can be buildings, land, or equipment. A Fixed Assets Schedule is created showing both the gross amount of the particular fixed asset and the corresponding accumulated depreciation. The purpose of this schedule is to make sure everything is being recorded as it should have been.
- **Example -**
- Let's assume opening balance of a particular asset at the beginning year is Rs. 100. Addition to this asset during the year was Rs. 50. The disposal/ sale of asset during the year was Rs. 25. The fixed asset roll forward for this asset will be:
- *Opening Balance + Additions - Disposals +/- Transfers = Closing Balance*
- $\text{Rs. } 100 + \text{Rs. } 50 - \text{Rs. } 25 + /- 0 = \text{Rs. } 125$

SCA - 103
Overall Objectives of the
Independent Cost Auditor
and
the Conduct of an Audit in
Accordance with Cost
Auditing Standards

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

Requirements of Standard

- **Ethical Requirements**
 - ✓ **Integrity** [*Being straightforward and honest in all professional relationships*]
 - ✓ **Objectivity** [*Not allow bias, conflict of interest or undue influence of others to override professional judgments*]
 - ✓ **Due care** [*to ensure that a client receives competent professional service based on current developments in practice, legislation and techniques*]
 - ✓ **Confidentiality** [*should not disclose any information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose and should not be used for the personal advantage for himself or third parties*]
 - ✓ **Professional Conduct** [*Should comply with relevant laws and regulations and should avoid any action that discredits the profession*]
 - ✓ **Independence** *enhance the auditor's ability to act with integrity to be objective and to maintain an attitude of professional scepticism.*

Code of Ethics have been issued by the Institute relating to Independence, Integrity, Objectivity, Professional competence, due care, Confidentiality and Professional conduct.

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

■ Professional Scepticism

- ✓ Being alert for:
 - Audit evidence that contradicts other;
 - Reliability of documents and responses to inquiries;
 - Possible fraud;
 - Circumstances that need additional audit procedures.
- ✓ Maintain professional scepticism throughout the cost audit
- ✓ Not expected to disregard past experience of the honesty and integrity of entity's management.

Professional scepticism 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.

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

■ Professional Judgment

- ✓ Materiality and Audit Risk;
- ✓ Nature, timing and extent of audit procedure;
- ✓ Evaluating whether sufficient appropriate audit evidence has been obtained, or more needs to be done;
- ✓ Drawing of conclusions based on the audit evidence obtained;
- ✓ Need to be exercised throughout the cost audit.

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.

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

▪ Sufficient Appropriate Audit Evidence and Audit Risk

✓ Cost Audit is matter of professional judgment rather than a matter of capable of precise measurement.

✓ **Risk exists at two levels;**

- **The overall cost statement level** – Material Misstatement
- **The assertion level** in relation to cost heads, items of cost and disclosure.
 - a. Inherent Risk
 - b. Control Risk
 - c. Detection Risk

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.

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

Types of Audit Procedures

1. Inspection of Cost Records, documents and other related information

- *Vouching*
- *Tracing (back to the source document)*
- *Scanning (to ascertain their authenticity and accuracy)*

During the scanning procedure, the cost auditor is on the lookout for unusual items, such as unauthorized debits of costs or fraudulent credits of in costs.

2. *Inspection of Tangible Assets;*

3. *Observation*

4. *Inquiry*

5. *Confirmation*

6. *Recalculation*

7. *Reperformance*

8. *Analytical Procedures*

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

Types of Audit Procedures



Classification of Audit Procedures

A. Risk Assessment Procedures *(in response to assessed risks)*

- 1. Inquiries of Management*
- 2. Analytical Procedure*
- 3. Observation and Inspection*

B. Further Audit Procedures

1. Test of Controls

2. Substantive Procedures

- (i) Substantive Analytical Procedure*
- (ii) Test of Details (Classes of Transactions;)*
- (iii) Test of Details (Accounts Heads;)*
- (iv) Test of Details (Disclosures)*

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

- **Conduct of an Audit in Accordance with SCAs**
 - ✓ Comply with all SCAs relevant to an audit of cot statements;
 - ✓ Have understanding of the entire text of an SCA;
 - ✓ Achieve overall objective as well as objectives stated in Individual SCA;
 - ✓ Complying with relevant requirements **unless**:
 - Entire SCA is not relevant;
 - Requirement is irrelevant because it is conditional & condition does not exist;
 - Departure from requirement in exceptional circumstances;
 - Perform alternative procedures to achieve aim of requirement.

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

■ Conduct of an Audit in Accordance with SCAs

✓ Failure to achieve an objective:

➤ Evaluate if the failure:

- Prevents auditor from achieving the overall objectives;
- Necessitates modified audit opinion;
- It is a significant matter for documentation.

The cost auditor may be required to comply with legal or regulatory requirements in addition to Cost Auditing standards. In such case in addition to complying SCAs, it will be necessary to perform additional audit procedures to comply with the legislative and regulatory requirements. The Cost Auditing Standards do not override the laws or regulations that govern audit process.

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

- **Cost Reporting Framework followed by management to be in line with the Companies Act and the Rules prescribed thereunder:**
 - ✓ Cost auditor is responsible for forming and expressing an opinion on the Cost Statements.
 - ✓ ***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.

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

5.1 Comply with the relevant ethical requirements including those pertaining to independence (refer 6.1)

Code of Ethics issued by the Institute relating to Independence, Integrity, Objectivity, Professional competence and due care, Confidentiality and Professional conduct.

For Example: The provision of services for maintenance of cost records, design and implementation of Cost Systems and internal audit are considered to erode the independence. Auditor not to render certain services: Section 144 of the Companies Act 2013.

5.2 Comply with each of the Cost Auditing Standards relevant to the audit. (refer 6.2)

[6.2 The cost auditor may be required to comply with legal or regulatory requirements in addition to Cost Auditing standards.

In such case in addition to complying SCAs, it may be necessary to perform additional audit procedures to comply with the legislative and regulatory requirements.

The Cost Auditing Standards do not override the law or regulations that govern audit process]

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

Requirements

5.3 The cost auditor shall have an understanding of the entire text of the Cost Auditing Standard, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.

5.4 The cost auditor shall not represent compliance with the cost auditing standards in the cost auditor's report unless the auditor has complied fully with all of the Cost Auditing Standards relevant to the audit.

5.5 In exceptional circumstances, the cost auditor may judge it necessary to depart from a relevant requirement in a Cost Auditing Standard. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. {Refer 6.2(c)}

[6.2 The need for the 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 audit, that procedure would be ineffective in achieving the aim of the requirement.

5.6 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. (refer 6.3)

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

[6.3 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.

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].

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)

[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].

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.

SCA - 103 Overall Objectives of the Independent Cost Auditor and the Conduct of an Audit in Accordance with Cost Auditing Standards

Requirements

5.8 The cost auditor shall exercise professional judgment in planning and performing the audit.

5.9 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 thereunder. (refer 6.5)

6.5 Responsibility for the Cost Statements: The cost auditor is responsible for forming and expressing an opinion on the Cost Statements. (Refer 5.9)

6.5(b) 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.

Requirements

5.10 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)

cost auditor to 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.

5.11 If an objective in a relevant Cost Auditing Standard 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 Cost Auditing Standards, to modify the auditor's opinion.

SCA-113: Using the Work of Internal Auditor

Cost Auditor's Responsibility for the Audit

- ✓ Cost auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by use of the work of the internal audit function or internal auditors to provide direct assistance on the audit engagement.
- ✓ Although Internal Auditor performs the audit procedures similar to those performed by the cost auditor, neither the internal audit function nor the internal auditors are independent of the entity as is required for the cost auditor in an audit of cost statements.
- ✓ This SCA, therefore, defines the conditions that are necessary for the cost auditor to be able to use the work of internal auditors.
- ✓ It also defines the necessary work effort to obtain sufficient appropriate evidence **that the work of the internal audit function, or internal auditors providing direct assistance, is adequate for the purposes of the cost audit.**

SCA-113: Using the Work of Internal Auditor

- ✓ Nothing in this SCA requires the cost auditor to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the cost auditor; **it remains a decision of the cost auditor in establishing the overall cost audit strategy.**
- ✓ Before using the work of Internal Auditor, the cost auditor to determine the following:
 - (i) Objectivity and Status of Internal Audit Function in entity
 - (ii) areas and the extent to which the work of the internal audit function can be used
 - (iii) relevance to the cost auditor's overall audit strategy and audit plan
 - (iv) *Cost Auditor should prevent himself to undue use of the work of the internal audit function and shall use less of the work of the internal auditor **and perform more of the work directly.***

SCA-113: Using the Work of Internal Auditor

- ✓ If the cost auditor plans to use the work of the internal auditor, he should discuss the planned use of its work with the internal auditor.
- ✓ Cost auditor shall read the reports of the internal auditor and obtain an understanding of the nature and extent of audit procedures the internal auditor performed and the related findings.
- ✓ Cost auditor shall perform sufficient audit procedures on the work of the internal auditor to determine its adequacy for purposes of the audit, including evaluating whether:
 - (a) *The work of the internal audit function had been properly planned, performed, supervised, reviewed and documented;*
 - (b) *Sufficient appropriate evidence had been obtained to enable the internal audit function to draw reasonable conclusions; and*
 - (c) *Conclusions reached are appropriate in the circumstances and the reports prepared by the internal auditor are consistent with the results of the work performed.*

SCA-110: Written Representation

1. SCA guides how to get Written representations from management as audit evidence, **the procedures to be applied in evaluating and documenting written representation,** and **the actions to be taken if management refuses to provide appropriate representations.**
2. Written representations are necessary information that the cost auditor requires in connection with the audit of the entity's cost statements. **Accordingly, similar to responses to inquiries, written representations are audit evidence.**
3. *Although written representations provide necessary audit evidence, but they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.*
4. *Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the cost auditor is required to obtain on specific assertions during the course of his audit.*
5. *The written representations shall be for all cost statements and period(s) referred to in the cost auditor's report.*

SCA-110: Written Representation

1. If management does not provide one or more of the requested written representations, the cost auditor shall:
 - (a) Discuss the matter with management;*
 - (b) Re-evaluate the integrity of management and evaluate the effect and audit evidence in general;*

2. ***The cost auditor shall disclaim an opinion on the cost statements if:***
 - (a) The cost auditor concludes that there is sufficient doubt about the integrity of management;***
 - (b) Management does not provide the written representations that fulfilled its responsibility for the preparation of the cost statements in accordance with the applicable cost reporting framework;***

Illustrative Written Representation

(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 Company/ factory/ Unit)**** for the ***(name the products/activities)**** 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.

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

Illustrative Written Representation

COST STATEMENTS

1. We have fulfilled our responsibilities as set out in the terms of the audit engagement contained in the letter dated _____ for the preparation of cost statements and to ensure that the cost statements in accordance with the applicable laws and the Cost Accounting Standards (CASs) issued or that may be issued from time to time by the Institute of Cost Accountants of India,/
CRA-1 of the Companies (Cost Records and Audit) Rules 2014 (as amended) 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.**

Illustrative Written Representation

3. *We have corrected the mis-statements in the cost statements reported by you in the course of audit. The effects of uncorrected mis-statements, if any, are not material, both individually and in the aggregate in the cost statements as a whole. A list of the uncorrected mis-statements is attached to this letter.*

MATTERS RELATING TO OPERATIONS

4. 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.**
5. We have provided you with access to all production / service facilities required for the purpose of Cost Audit.
6. The capacity of Product(s)/Service(s) are 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.
7. 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.

Illustrative Written Representation

COST MEASUREMENT AND ASSIGNMENT

8. **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.
9. Where costs are spread over periods based on benefits received, significant assumptions made in this regard are reasonable. **
10. We have applied our best judgement 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.

Illustrative Written Representation

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.
15. All outstanding liabilities (*including those of income tax, GST and other taxes and duties where applicable*) and outstanding incomes and assets have been provided for in the accounts.

The inventory includes all goods which are the property of this company wherever located, including goods sent on consignment account to customers.

INFORMATION PROVIDED

- We have provided you with -

Illustrative Written Representation

- 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 entity 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.*

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.*

Illustrative Written Representation

- b) Details on 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 and that affects the entity and involves*
- Management
 - Employees who have significant roles in internal control.
 - Others where the fraud could have a material effect on the financial 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.*
- f) The identity of the entity's related parties and all the related party relationships and transactions with them of which we are aware.*

Illustrative Written Representation

17. We have provided you with all documentary evidence in support of the bases adopted to determine the normal price in respect of related party transactions and inter-company transfer and there is no shifting of profits between units to the detriment of ordinary investors at large.

ADEQUACY OF SYSTEMS

18. 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.

19. There are no persistent deficiencies in the cost accounting system pointed out in earlier cost audit reports but not rectified.

20. 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.

Illustrative Written Representation

21. 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 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.*

*** In case of change, please give details including the impact on unit cost of production or cost of operation, cost of sales and margin of the company/factory/unit and Product/ Service wherever applicable.*

Examples of Misstatements in Cost Statements, either due to error or fraud

- 1. Understatement or overstatement of installed capacities***
- 2. Misstatement in measurement, classification, allocation, apportionment and absorption of costs***
- 3. Misstatement of costs with a view to claim higher subsidies or evade taxes or due to error***
- 4. Over-valuation or under-valuation of inventory either due to error or with a view to manipulate profits and taxes***
- 5. Wrong consumption of raw materials, utilities and other inputs resulting in misstatement in cost of production***
- 6. Misstatement in production and sales records to evade taxes***
- 7. Wrongful recognition of revenues***
- 8. Wrong classification of joint-products or by-products***
- 9. Significant variations in physical inventories vis-a-vis stock statements***
- 10. Non or wrong recognition of idle capacities, idle facilities, idle manpower, etc.***

Examples of Misstatements in Cost Statements, either due to error or fraud

- 11. *Overstatement or understatement of scrap, defectives, wastages, spoilage, etc.***
- 12. *Non-recognition of cases of thefts, pilferage, etc., if any***
- 13. *Recognition of abnormal costs as normal costs or vice versa***
- 14. *Recognition of non-cost items as costs or vice versa***
- 15. *Inappropriate traceability of costs to particular cost objects***
- 16. *Misstatement in arm's length price in relation to transactions with related parties***
- 17. *Wrong certification of stocks lying with third parties***
- 18. *Over or under invoicing of purchases or sales***
- 19. *Recognition of fake bills of purchases of goods and services***
- 20. *Recognition of costs not actually incurred***
- 21. *Treatment of capital as revenue or vice-versa***
- 22. *Booking of fake manpower costs not actually engaged***
- 23. *Wrongful recognition of group companies' costs or assets***

Examples of Misstatements in Cost Statements, either due to error or fraud

- 24. Recognition of dead or unserviceable stocks as 'good' inventories or vice versa**
- 25. Recognition of third party stocks as own stocks or vice versa**
- 26. Non-booking of costs already accrued**
- 27. Misstatement in quantities and values showing material mismatch with cost estimates**
- 28. Treatment of self-manufactured materials, components, sub-assemblies, tools, etc. as purchases**
- 29. Valuation of international transactions at wrong forex rates**
- 30. Wrongful recognition of subsidies, grants, incentives, etc.**
- 31. Recognition of imputed costs**
- 32. Recognition of defectives production as good ones or vice versa**
- 33. Recognition of semi-finished goods as finished goods or vice versa**
- 34. Under or overstating life of assets [or additions to or deletion of assets] resulting in over or undercharging of depreciation or amortization**

*Thank
you*



**Former Senior Director
(Technical)**

**The Institute of Cost
Accountants of India**

**Former CEO, IPA of
Institute of Cost
Accountants of India**

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