THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

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Practical Guide to the Standard on Cost Auditing (SCA) 101 - Planning an Audit of Cost Statements

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Guidance Note

Cost Audit & Assurance Standards Board
March, 2017

This guidance note is designed to assist the practitioner / members / stakeholders to understand the requirements of Standard of Cost Auditing -101 "Planning an audit of Cost Statements".

Disclaimer

This Practical Guide [Guidance Note] primarily relates to the Standard on Cost Auditing [SCA-101] - "*Planning an Audit of Cost Statements*".

For better understanding of professional members, students and other stakeholders, relevant material from following three Standards on Cost Auditing already approved by the Central Government has been drawn at the appropriate places.

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

Similarly, relevant material has also been drawn at appropriate places from all other Standards on Cost Auditing viz. SCA-105 to SCA-119 that have been approved by the Council of the Institute of Cost Accountants of India but are still in the process of approval by the Central Government. These Standards, as they stand today, are available on the Institute's website. Any changes made in these Standards by the Central Government, to the extent used in this Guidance Note, shall stand replaced accordingly and be read & understood as per the approved version.

The Cost Audit & Assurance Standards Board and the Council of the Institute disclaims any responsibility or liability that may occur, directly or indirectly, as consequence of the use and application of this Guidance Note.

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CHAPTER –1 INTRODUCTION

PREAMBLE

Cost Accounting is process of identification, classification, measurement, and assignment of costs to various cost objects. Preparation & Presentation of cost records and cost statements is the responsibility of the Management. Therefore, Cost Accounting standards are guidelines for the companies [for the management] that specify the cost accounting treatment for various cost elements, minimum disclosure requirements and ensure the comparability, consistency, and completeness of cost records.

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. Standards on Cost Auditing provide guidance to the cost auditor through each step of the audit process with regard to the audit procedures to be followed; responsibilities of the cost auditor; and cost reporting.

Standards are nothing what converting the commonly accepted practices, procedures and requirements into a document called "Standard". Practices, procedures and principles relating to cost accounting are covered in the Cost Accounting Standards; and practices, procedures and requirements relating to cost auditing are covered in the Standards on Cost Auditing.

Standards on Cost Auditing are best friends, best guide and best helpdesk for the cost auditor. If followed scrupulously, the standards would help the cost auditor to streamline audit, to do better planning, better documentation, and effective implementation. Thus, these will help in improving the overall quality of audit. The cost auditor should carefully go through the standards and make best use of them. Should read SCA 103 first [objectives of independent audit], then 104 [understanding the business], followed by 101 [planning] and 102 [documentation]. Take the client on board; send him a brief of the applicable Standards and discuss. Use the standards to the extent these are applicable to the nature and scope of audit. The Standards authorize the cost auditor to use the work of another auditor or expert – hence don't check every detail again which is already audited by another auditor or is certified by an expert. Therefore, if required & satisfied, the cost auditor can rely on the work done by another auditor/expert. The Standards are not to be remembered, but to be practiced by making these a part of the work culture and teaching these to the entire audit team.

BACKGROUND

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

In accordance with the aforesaid provisions of Companies Act, 2013 and after approval by the Central Government, the Institute of Cost Accountants of India has issued the Standard on Cost Auditing [SCA/CAS] – 101 on Planning an Audit of Cost Statements. This Standard is considered necessary to guide the members in planning for the audit of cost statements so that it is performed in an efficient and effective manner to ensure achievement of audit objectives with available resources and securing coordination with the auditee on audit work as mandated under section 148 of the Companies Act, 2013. The Guidance Note deal with the practical aspects of audit strategy and audit plan in accordance with the requirements enshrined in SCA-101: Planning an audit of cost statements.

While formulating the Standards, the Cost Auditing & Assurance Standards Board [CAASB] of the Institute takes into consideration the applicable laws, usage and business environment prevailing in India. CAASB also takes into account the 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. The Standards issued by the CAASB are aligned, to the extent possible, with other recognised Standards issued in India and prevailing International Practices.

As already said in the Preface to the Standards on Cost Auditing, if a particular Standard or any part thereof is inconsistent with a law, the provisions of the said law shall prevail.

Disclaimer

This guidance note is designed to assist the practitioner / members / stakeholders on the understanding of Standard of Cost Auditing -101 "Planning an audit of Cost Statements", but not intended to be a substitute for the requirements for SCA themselves, Furthermore, practitioner should utilize this guide in light of his/her professional judgement and facts and circumstances involved in each particular cost audit. The Institute disclaims any responsibility or liability that may occur, directly or indirectly, as consequence of the use and application of this Guidance Note.

AUDIT PLANNING

The audit [process] planning is a fundamental basis in the exercise of audit process. The cost auditor should develop plans and strategies to avoid potential issues. The plan includes an upgraded help in identifying problems well in advance, regardless of their size and complexity. The audit strategy would involve setting such audit procedures so as to solve these problems and ensure a neutral and clean opinion about the fairness and credibility of the company's cost statements, when audited.

Cost auditor is required to plan the audit by developing an audit strategy to guide the plan itself. Audit planning is necessary for number of reasons of which the foremost is to achieve audit efficiency and effectiveness. Audit plan involves planning risk assessment procedures, and other audit procedures to obtain sufficient & appropriate audit evidence. During the course of audit, if the cost auditor concludes that the initial plan requires alteration, then cost auditor shall consider revising audit strategy as well, if needed. Change in audit plan involves change in the scope, timing or extent of planned audit procedures. Cost auditor shall document the audit plan and any changes thereto.

It is reasonable to assume that planning occurs towards the start of an audit engagement. However, according to SCA 101, planning should not be seen as a discrete and separate part of the overall audit. Planning often begins shortly after, or in connection with the completion of the previous audit. For example, it involves review of issues that were discussed with the management, such as control deficiencies or unadjusted errors or abnormal losses. Such matters are relevant to the next year’s cost audit and need to be considered when planning.

Similarly, the audit plan may be revised as the audit progresses, and should not be viewed as being fixed in place once the main planning phase has ended. For example, a significant change in process / production activities may take place as the audit of cost statements is in progress, meaning that the audit plan needs to be changed.

The nature and extent of planning activities depends on the size and complexity of the audit client, previous experience of the audit firm with the entity, and any changes in circumstance that may occur during the audit of cost statements.

Need of Audit Planning

Adequate planning helps the cost auditor in auditing cost statements in number of ways and includes:

- Giving suitable attention to important areas of audit
- Identifying and resolving problems in timely manner
- Organizing and managing cost audit to conduct it efficiently and effectively

- Helping cost auditor in selecting audit team members and assigning work to them
- Facilitating cost auditor to direct, supervise and review the work of team members
- Helping in coordinating work of other auditors and experts

Benefit of Audit Planning

- Team member learn from the experienced/ insight of the partner and other key personnel
- The engagement is properly organized, staffed, and managed
- Experienced gained from previous engagements and other assignments is properly utilized
- Important areas of the audit receive the appropriate attention
- Potential problems are identified and resolved on a timely basis
- Audit file documentation is reviewed on a timely basis
- Work performed by other experts is coordinated (other auditors, internal auditors, cost auditor experts)

Role and Timing of planning

The nature of audit planning depends on:

- Size and complexity of an entity;
- Cost auditor's previous experience of the same entity; and
- Changes in circumstances during audit engagement

It is not a standalone stage of an audit which takes place at the start of every audit. Moderately planning can be done or revisited as and when it is needed even during the audit engagement i.e. it is an iterative and continual process.

Planning is not a discrete phase of an audit, but rather a continuous and iterative process.

Planning often begins shortly after (or in connection with) the completion of previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that needs to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

- ❖ Analytical procedures
- ❖ Obtaining an understanding of the applicable legal and regulatory framework and how the entity is complying with applicable framework i.e. Power Generation Sector, Telecom Sector

- The determination of level of materiality
- The involvement of experts, if required
- The performance of assessment procedures as applied in previous audit of cost statement, if any

The cost auditor may discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the cost auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

Planning also includes scheduling which involves determining the priority of audit procedures and their inter dependence. For example, the risk assessment procedures are planned early in the audit process.

CHAPTER -2 OVERVIEW

It is very important for auditors to properly plan the audit work to be carried out. Without proper planning, the objectives of the audit will not be achieved and the auditor runs the risk of failing to detect a material misstatement. In addition to this, lack of evidence of proper planning could lend support to a case for professional negligence.

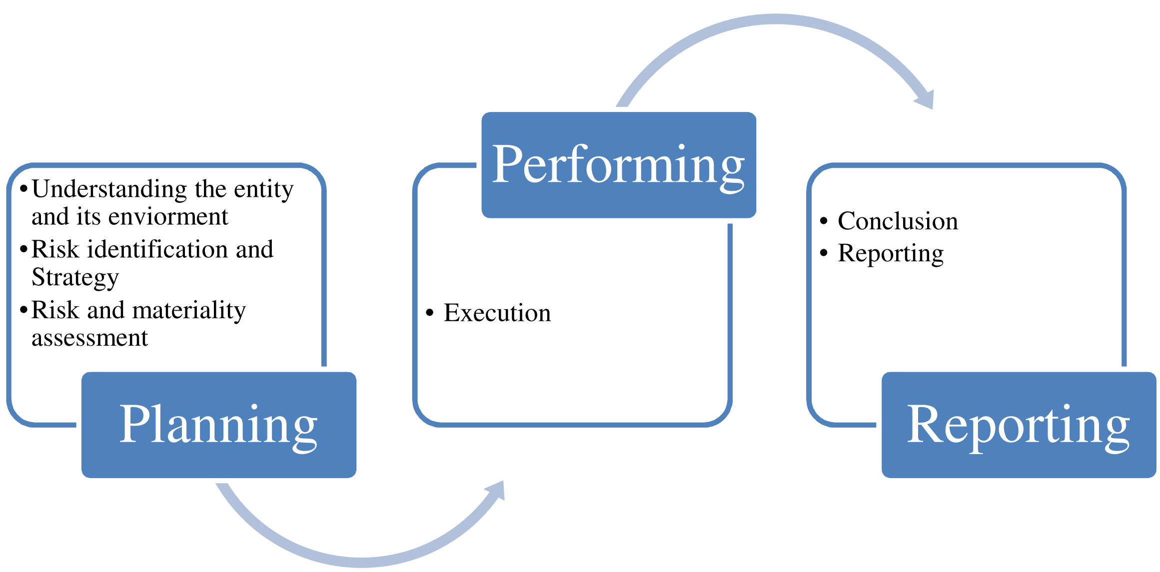
It is essential to understand an overview of the various stages of the audit and preconditions for an audit of cost statements, This chapter will provide the stages of a cost audit, the audit process and finally exhibit the detailed audit process with required audit procedures with the help of figures.

Before commencing discussion of audit planning, one may need to understand the pre-planning process for an audit of cost statements. SCA-105 defines certain pre-conditions for an audit of cost statements that have been discussed in detail in a separate chapter.

The stages of an audit of cost statements are

1) Planning,
2) Performing, and
3) Reporting.

Overview of the Cost Audit



Once the entity's acceptance or continuation decision has been made, the first stage is planning the audit. Broadly, the planning stage involves gaining an understanding of the client, identifying factors that may impact the risk of a material misstatement in the cost statements, performing a risk and materiality assessment, and developing an audit strategy. The risk of a material misstatement is the risk that the cost statements include a significant error or fraud. The execution stage (or performing stage) of the audit involves the performance of detailed testing of internal controls and substantive testing of cost accounting policies & procedures. The reporting stage involves evaluating the results of detailed testing in light of the cost auditor's understanding of the entity and forming an opinion on the fair presentation of the entity's cost statements as a whole.

Planning an audit - First Stage

"It is well said that a well planned audit is almost half way done"

The planning stage involves determining the audit strategy as well as identifying the nature and the timing of the procedures to be performed. This is done to optimize efficiency and effectiveness when conducting an audit. Efficiency refers to the amount of time spent gathering audit evidence. Effectiveness refers to the minimization of audit risk. A well-planned audit will ensure that sufficient appropriate evidence is gathered to minimize risk of material misstatement at the cost statement level. The figure above provides a graphical depiction of the preliminary risk identification process used during the planning stage of each audit.

Performing an audit – Second Stage

The performance, or execution, stage of the audit involves detailed testing of internal controls, material consumptions, cost accumulation, allocation, apportionment, and absorption. If an auditor plans to rely on their client's system of internal controls, they will conduct tests of controls. Cost auditor will conduct detailed substantive tests of audit procedures for the year and detailed substantive tests of consumptions and balances recorded at period end. This detailed testing provides the evidence that the cost auditor requires to determine whether the cost statements are fairly presented.

Concluding and reporting on an audit – Final stage

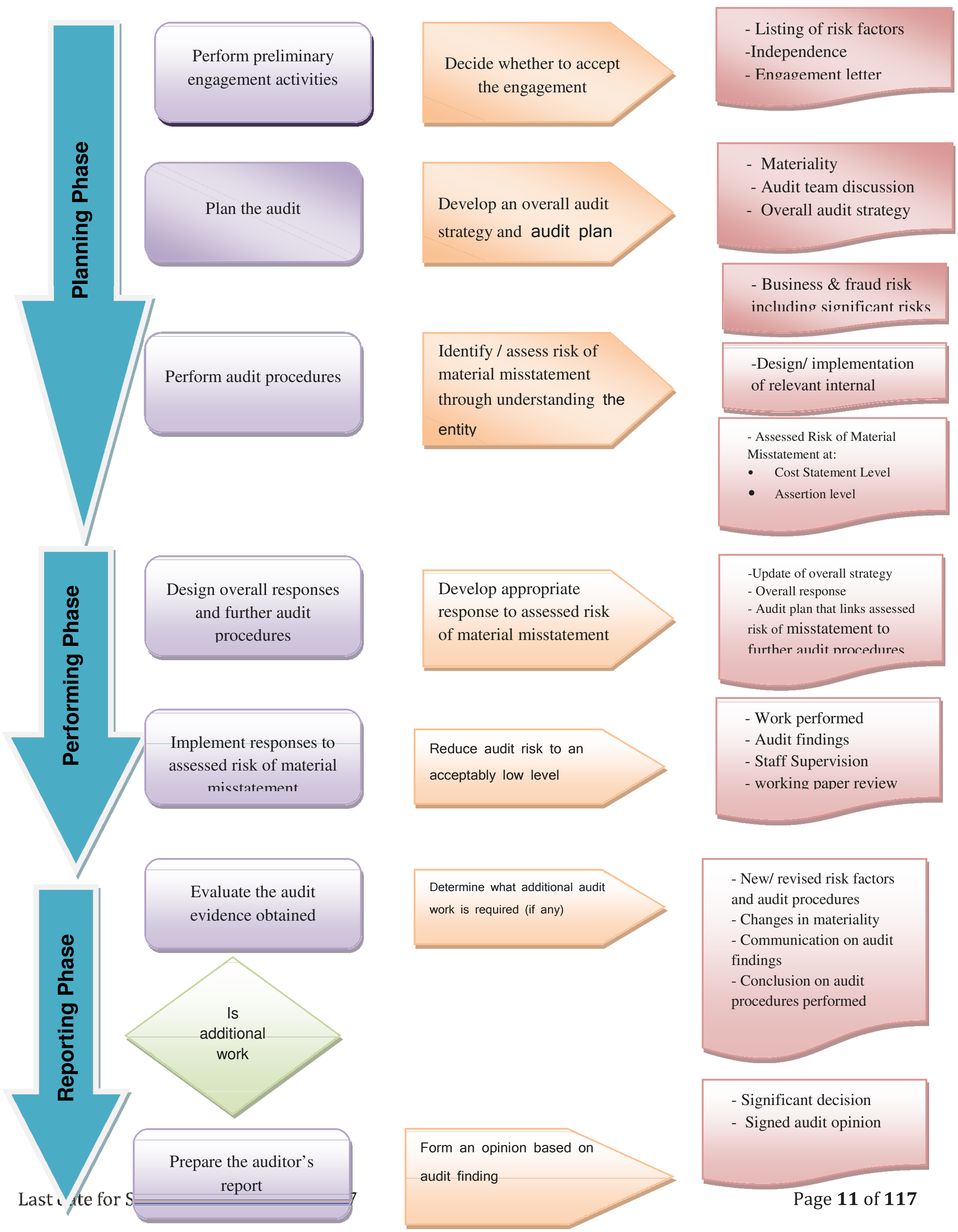
The final stage of the audit involves drawing conclusions based on the evidence gathered and arriving at an opinion regarding the fair presentation of cost statements. The cost auditor's opinion is expressed in the cost audit report. At this stage of the audit, a cost auditor will draw on their understanding of the client, their detailed knowledge of the risks faced by the client, and the conclusions drawn when testing the entity's controls, transactions, cost heads, item of cost and related disclosures.

AUDIT PROCESS

This is exhibited in figure; the user of this manual is required to have an understanding of all the SCAs to understand the below exhibited audit process.

Audit Process

Activity **Purpose** **Documentation**



PRACTICAL STEPS OF AUDIT PROCESS

The points given below summarize what a cost auditor does when he undertakes any audit:

Stage-I Steps – Objectives of Audit and Management Outlook [SCA 103]

- Is the audit only for meeting with the statutory requirements
- Or do the management have any other expectations or outcomes in its mind from the cost audit, such as
    - cost optimization or cost reduction
    - checking parameters of operational efficiency of a unit or any utility or any other function or department
    - suggesting product diversification or changed product-mix
    - identifying profit making or loss making products
    - suggesting changed marketing strategies; market expansion; market diversification
    - complete review of business strategies

Stage-II Steps – Pre-conditions

- The cost auditor should fully understand the
    - Objectives of cost audit
    - Area, nature and scope of audit
    - Number of cost auditors appointed
    - The applicable reporting framework
    - The reporting period
    - The statutory deadlines
- Do the Management understand its scope of work and responsibilities for
    - maintenance of cost records & producing them to the cost auditor
    - preparation & presentation of cost statements & other details as per the applicable reporting framework, and in compliance with the cost accounting standards
    - selection and consistent application of appropriate cost accounting policies
    - allowing access to the auditor all information, including the books of accounts, vouchers, cost records, other records, documents, and other

matters of the company, which are relevant to the preparation of the cost statements

- providing additional information that the cost auditor may request from the management for the purpose of cost audit
- allowing unrestricted access to persons within the company from whom the cost auditor determines it is necessary to obtain cost audit evidence
- giving proper management representation

- The auditee and the cost auditor decides the audit fee and payment schedule; and finally, the cost auditor gets an engagement letter
- All these are called pre-conditions of audit

Stage-III Steps – Understanding the Company's Business [SCA 104]

- The cost auditor is required to understand the company's business, its corporate structure and various systems followed.
- The company related details and other general details include
  - The company, its nature of activities, its size, product profile, unit locations, ownership structure, management structure, organisational structure, marketing set-up, accounting set-up, etc.
  - The nature of the industry or the sector in which client company operates
  - The applicable regulatory framework, financial reporting framework and cost reporting framework
  - The company's production process, product details, joint or by-products, outsourcing, if any
  - Details of subsidiaries, associates and joint ventures
  - Key personnel in all departments including in Finance, Accounts, Costing, IT, Administration, Production, Purchase, Sales, etc
  - Purchase policy, sales policy, pricing policy, export/import policy
  - Inventory receipt, storage, issue & pricing policies; physical verification system; inventory management system
  - Related parties and nature of transactions with them
  - Indirect tax structure, as applicable
- Internal Control Systems followed by the company

- Internal Audit System, its scope & adequacy of coverage as well as effectiveness
- Accounting systems & Policies followed by the company
- Cost Accounting System & Policies followed by the company
- Company's MIS system, risk identification & management system
- IT architecture followed for financial accounting and for cost accounting; IT policy, control checks, authorization checks; IT data security policy
- Previous auditor's report

Stage-IV Steps – Planning the Audit [SCA 101]

Planning the audit include

- Timing [dates] and duration [no. of days] of audit period; including plan to visit the unit(s)
- Level and number of audit personal to be deployed; including supervision and review of work done by the audit team
- Audit partner to be deployed; his expected days & dates
- Drawing up an overall audit plan and audit strategy – this will act as guide to the audit team
- Deciding the materiality levels & sampling levels
- Formulating appropriate audit procedures
    - Management Representation
    - Management Assertion
    - Test of Controls
    - Test of Details
    - Substantive procedures
    - Analytical procedures
- Formulating risk assessment strategies & procedures
    - Methodology to measure material misstatements
- Planning for discussions with key personnel of the company
- Planning for discussion with the previous cost auditor, statutory financial auditor, and internal auditor
- Key inputs for planning are
    - results of preliminary activities as specified above

  - knowledge from previous audits and other engagements with the company
  - knowledge of business
  - nature and scope of the audit
  - statutory deadlines and reporting format
  - relevant factors determining the direction of the audit efforts
  - nature, timing and extent of resources required for the audit

- Document the Audit Plan and share it with the company
- Ensure adherence to the Guidance Manual for Audit Quality

Stage-V Steps – Execution of Audit

- Perform the audit checks and procedures, as planned
- Collect all required audit evidence enabling the auditor to form his opinion
  - validate their relevance and reliability
  - check their accuracy, completeness and sufficiency
  - check the source and consistency
- Prepare draft observations & discuss with key management personnel
- Prepare final audit report

Stage-VI Steps – Audit Documentation [SCA 102]

- Document audit plan, audit strategy
- Document all working papers
- Document all the audit evidences
- Document draft observations and discussions
- Document final report
- Preserve all documents in a bound folder/file for the prescribed period

CHAPTER – 3 DEFINITIONS

This chapter provides an understanding about the definitions given under SCA-101 and other relevant definitions that provide inherent application of such concepts in planning of an audit of cost statements. Few important definitions are explained in latter part of this chapter enabling the cost auditor to thoroughly understand the requirements of SCA-101.

SCA-101 DEFINITIONS

Audit: *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.*

Audit Partner: *Audit partner means the partner 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 audit 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.*

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

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

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

1. ***Inherent risk:*** *the susceptibility of an assertion about the measurement, assignment or disclosure of cost to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.*

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

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

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

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

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

Cost Auditor: *"Cost Auditor" means an auditor appointed to conduct an audit of cost records and shall be a cost accountant within the meaning of The Cost and Works Accountants Act 1959. "Cost 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.*

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

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.*

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.*

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

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.*

OTHER DEFINITIONS

The following relevant definitions have been drawn for reference from other three Standards on Cost Auditing approved by the Central Government. Similarly, few more relevant definitions are drawn from those Standards on Cost Auditing that have been recommended by the Council of the Institute but are in process of approval by the Central Government. List of all the Standards is appended in Appendix-I. This will provide conceptual clarity and broader understanding while planning for an audit of cost statements:

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.*

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 decisions about the courses of action that are appropriate in the circumstances of the audit engagement.*

Professional Skepticism: *An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatements due to error or fraud, and a critical assessment of audit evidence.*

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.*

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 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.

EXPLANATIONS

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.

Performance Materiality

According to **SCA 108,** *'A matter is material if its omission or misstatement would reasonably influence the economic decisions of users taken on the basis of the cost statements.'*

Performance materiality as the level or amounts set by the cost auditor at less than materiality for the cost statements as a whole or particular items of cost to reduce the audit risk to an appropriately low level, the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the cost statements as a whole. If applicable, performance materiality also refers to the materiality level(s) set by the cost auditor at less than the materiality level or levels for particular items of cost, cost head or disclosures.

During the planning process, the cost auditors will review the information they have obtained about the entity's operational results for the period and make a preliminary estimate of materiality for the cost statements as a whole. They will also look at particular item of cost, for example BOM Cost, Production Overheads, etc. and make an estimate of what they would consider to be a material misstatement for that item of cost. However, during the actual audit work, the cost auditors will set performance materiality at a lower level of materiality than they had during the planning stage, i.e. smaller items now become material. The levels of planned materiality and performance materiality should be constantly reviewed during the audit and revised as appropriate.

SCA-108, also enumerates the concept of materiality and its determination and application in context of cost audit. This is summarized below:

The cost auditor's determination of materiality is a matter of professional judgment, and is affected by the cost auditor's perception of the cost information needs of users of the cost statements. In this context, it is reasonable for the cost auditor to assume that users:

- Have a reasonable knowledge of business and economic activities and willingness to conduct the audit of cost statements with reasonable diligence.
- Recognize the uncertainties inherent in the measurement of cost based on the use of estimates, judgement and consideration of event taken place.
- Make reasonable decisions on the basis of the information gathered and available.
- Use of benchmark in determining materiality for cost statements as a whole
- Revision of materiality level as the cost audit progresses.

Calculation of materiality level at cost statement level

The arrival at a materiality level for the cost statements as a whole is, again, dependent on the cost auditor's professional judgement. However, over the years there has been a customary practice to apply percentages to certain areas of the cost statements and use those in arriving at a cost statement materiality level. For example:

- ½ to 1% of turnover / BOM cost
- 1 to 2% of gross assets (balance sheet total))

- I to 2% of Cost of production/ Cost of Goods sold before tax
- 2 to 3% of gross or net contribution.

The use of percentage amounts in arriving at a cost statement materiality level is not prescriptive and the benchmarks above are given as a guideline only. Alternative methods of calculating cost statement materiality may well be more appropriate as no two audits will be the same. Depending on the levels of risk, the cost auditor may determine that the above calculations give too a high a materiality level and will therefore either reduce the percentages accordingly (depending on their past experience and risk assessment) or may apply a completely different way of arriving at a cost statement materiality altogether.

Professional Judgement

The professional judgement is very essential to the proper audit of a cost statement. This is because interpretation of relevant ethical requirements and the requirements to comply with the principles enshrined in the Standards on Cost Auditing and the informed decisions required throughout the cost audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances.

Professional Judgement is necessary in particular regarding decision about:

- Materiality and audit risk.
- The nature, timing and extent of audit procedures used to meet the requirements of the SCAs and gather audit evidence.
- Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the overall objectives of cost auditor(s).
- The evaluation of management's judgements in applying the entity's applicable cost reporting framework.
- The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the cost estimates made by management in preparing the cost statements as whole.

Misstatement

In general term, a misstatement is the difference between:

- the size of a figure as shown in the cost statements or how it has been disclosed or presented and

- the size it should be if it had been properly calculated, or what its correct disclosure or presentation should be if the relevant cost accounting standards had been applied correctly.

Misstatements may result from:

- Inaccuracy in gathering, classifying, and /or processing data from which the cost statements are prepared. For example, items of cost incorrectly taken from the cost records and included in the cost statements or calculation error or simple mistakes in posting figures / cost heads classification of cost.
- Amounts or statutory disclosures omitted, for example failing to fully disclose related parties transactions.
- Incorrect cost estimates arising from misinterpreting facts or overlooking or clear misrepresentation of facts which is relevant to the calculation of the cost estimate, for example basis of calculating and normal and abnormal losses.
- Estimates based on judgements which are clearly excessive or unreasonable in the circumstances. This includes the use of cost accounting principle, methods & policies which are unreasonable or inappropriate, for example revaluating plant equipment over useful years where it's useful life is considerably less may leads to under absorption of depreciation amount in cost statements.

SCA-111 Para 6.1 requires that cost auditor to assess whether an individual misstatement or aggregate of misstatements approaches materiality, if so, communicate the same with management for appropriate correction, evaluate the effect of uncorrected misstatement, communicate with those charged with governance, and appropriately document the conclusion and the basis for arriving at the conclusion

Uncorrected Misstatement*:* Misstatement that the cost auditor has accumulated during the audit and that have not been corrected.

Conditions and Events that may indicate Risks of Material Misstatement

The following are examples of conditions and events that may indicate the existence of risks of material misstatement. The examples provided cover a broad range of conditions and events; however, not all conditions and events are relevant to every audit engagement and the list of examples is not necessarily complete. *(Refer SCA-117- Appendix 2)*

- ❖ Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies
- ❖ Operations exposed to volatile markets

- Operations that are subject to a high degree of complex regulations
- Going concern and liquidity issues including loss of significant customers
- Constraints on the availability of resources, manpower and credit facility
- Changes in the industry in which the entity operates
- Changes in the supply chain
- Developing or offering new products or services, or moving into new lines of business
- Expanding into new locations
- Changes in the entity such as large acquisitions or reorganizations or other unusual events
- Entities or business segments likely to be sold or plant and facilities likely to be leased
- The existence of complex alliances and joint ventures
- Use of off balance sheet finance, special-purpose entities, and other complex financing arrangements
- Significant transactions with related parties
- Lack of personnel with appropriate accounting, recording and apportionment of cost and reporting skills
- Changes in key personnel including departure of key executives
- Deficiencies in internal control, especially those not addressed by management
- Inconsistencies between the entity's IT strategy and its business strategies
- Changes in the IT environment
- Installation of significant new IT systems related to financial and cost reporting
- Inquiries into the entity's operations or cost reporting framework by regulatory or government bodies
- Past misstatements, history of errors or significant adjustments at period end
- Significant non-routine or non-systematic transactions including intercompany transactions and large cost transactions at period end
- Cost transactions that are recorded based on management's intent, for example, allocation and apportionment of costs to unrelated products, wrong classification of expenses, items of cost and cost heads
- Application of new techniques of costing

- Cost measurements that involve complex processes
- Events or transactions that involve significant measurement uncertainty, including cost accounting estimates

The cost auditors must consider all the misstatements, or errors, they detect during the course of their audit work and make a judgement about how they could affect the cost statements. This will involve discussion with the management about amending the cost statements where individual misstatements are material. If the misstatements are individually small this will involve deciding whether, collectively, they are significant enough to affect the presentation of the cost statements as whole ; *lots of small errors can add up to a large one!*

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

There is no literature that has given an exhasutive list of areas of mistatements in cost records and cost statements, arising either due to error or fraud. However, for the benefit of cost auditors, a tentative list of such areas is given below.

- Understatement or overstatement of installed capacties
- 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
- 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, pilfirage, 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
- 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
- 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

The cost auditor is not required to restrict the audit procedures only to the areas listed above. He should draw his own audit procedure keeping in view the,

- nature of industry;
- scale/size or complexity of operations;
- applicable regulatory framework;
- applicable cost reporting framework;
- consistency in accounting policies and cost accounting policies;
- adequacy & effectiveness of internal control systems;

- performance of statutory and internal auditors;
- relationship of those charged with governance with management;
- level of transactions with related parties;
- level of transactions with governmental agencies;
- level of disputes with government authorities;
- complexity of value chain;
- effect of globalization;
- risk management structure/system;
- whistleblower policy; and
- past behaviour of the company.

Audit Risk

Audit Risk is the risk of expressing an inappropriate audit opinion on cost statements that are materially misstated. The objective of audit is to reduce this risk to an acceptably low level. The cost auditors may certify that the cost statements give a true and fair view when they actually do not exists in letter and spirit. In other words the cost statements contain a significant error or misstatement which the cost auditor(s) have failed to detect.

Audit Risk = Inherent Risk x Control Risk x Detection Risk

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.

- 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 internal controls, such as
  - Totalling mistake
  - Mistake to correctly carry the opening balances
  - Failure to account for all expenses relating to the year
  - Wrong assessment of capacity
- Control Risk is the risk of a material misstatement in the cost statements arising due to absence or failure in the operation of relevant internal controls of the entity, such as
  - Failure to perform supervisory or authentication checks
  - Failure to verify the veracity & accuracy of information
  - Failure to control frauds [fake staff bills, fake production, fake sales, fake consumption,
- 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. To reduce audit risk to an acceptably low level, the cost auditor is required to:

- Assess the risks of material misstatement;
- Limit detection risk. This may be achieved by performing procedures that respond to the assessed risks of material misstatement, both at the cost statement level and at the assertion level for cost heads, items of cost, and disclosures;
- Inherent risk assessment should be made before the commencement of the audit of cost statements to ensure that the existence of a material misstatement either individually or when aggregated with other misstatements is detected and also an assurance to the satisfaction of the auditor derived that it is nil or acceptable to a lower level so as not to distort the cost statements significantly;
- The cost auditor should assess the controls prevailing at various levels to ensure and satisfy that the operating and financial controls are adequate and acceptable;
- Study the reports of the Internal Auditors, Statutory Auditors and other agencies being engaged by the Company and address the scope, nature and depth of audit procedures to be applied to perform his duties efficiently as a cost auditor;
- As far as the risk assessment is concerned, the engagement partner should directly involve himself together with team who will involve in the audit. This is essential because, while conducting the enquiries about the control aspects, the officials of the auditee at various levels may fail to provide complete information. It is the efficiency of the auditor to bring out the details to his satisfaction so as to frame the appropriate mind-set and opinion in determining the depth of the audit to be undertaken in each of the audit environment concerned.

Based on the above, the partner/ proprietor of the firm should plan the time schedule to complete the risk assessment as this forms the foundation of the whole audit completion.

Risk at the assertion level

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

Risk Assessment

The purpose of risk assessment procedures is to identify and assess risks of material misstatement. This is achieved through understanding the entity and its environment, including internal control. Information may be obtained from external sources, such as the industrial benchmarking data and trade publications, and from internal sources such as discussions with key personnel. This understanding of the entity becomes a continuous, dynamic process of gathering, updating and analyzing information throughout the cost audit.

Risk assessment procedures provide audit evidence to support the assessment of risks at the cost statement and assertion levels. However, this evidence does not stand alone. Evidence obtained from risk assessment procedures is supplemented by further cost audit procedures (that respond to the risks identified) such as tests of controls and/or substantive procedures. The cost auditor uses professional judgment to determine the risk assessment procedures to be performed, and the scope or depth of understanding of the entity that is required.

The three risk assessment procedures:

(a) Inquiries of management and others
(b) Observation and Inspection
(c) Analytical Procedures

Changes due to circumstances can change the level of risk and may cause higher risk to controls which may leads to significant risks to cost reporting framework such as the followings:

❖ *Change in operating environment:* Changes in the regulatory or the operating environment can result in changes in competitive pressures and significantly different risks.

❖ *New personnel:* New personnel may have different focus on or understanding of internal control.

❖ *Rapid growth:* Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.

❖ *New Technology:* Incorporating new technologies into production processes or information systems may change the risk associated with control activities.

❖ *New business models, products, or activities:* Entering into business areas or transactions with which an entity has little experience may introduce new risk associated with controls.

- *Corporate Restructuring:* Restructuring may be accompanied by diversification, business integration, process integration and changes in supervision or segregation of duties that may change the risk associated with control functions.
- *Expanded foreign operations:* The expansion or acquisition of foreign operations carries new and often unique risk that may affect controls, for example transfer pricing issues.
- *New cost accounting pronouncements:* Adoption of new cost accounting or changing cost accounting principles may affect the risks in preparing cost statements.

Types of Risks

CHAPTER – 4 REQUIREMENTS

This chapter provide an understanding about the requirements of *SCA-101* and its interrelation with relevant requirements of other SCAs. This chapter also cover the related application guidance as provided under *SCA-101 "Planning an audit of Cost Statements"* and further guidance to intensively understand the objective of requirement.

REQUIREMENTS UNDER SCA-101

The requirements as given in the SCA-101 "Planning an Audit of Cost Statements" are reproduced below:

5.1 ***Prior to entering the planning phase, the Cost Auditor shall ensure that:***

(a) the appointment as cost auditor is proper, he has received the letter of appointment and legal formalities regarding his appointment have been complied with;

(b) the ethical requirements as per the regulations continue to be satisfied;

(c) an understanding of the terms of reference including the units to be covered, products/services to be covered, scope of coverage where the regulations leave it to be agreed between the auditor and the auditee.

5.2 ***The audit partner and other key members of an audit team shall be involved in planning the audit, including planning and participating in the discussion among audit team members.***

5.3 ***The Cost Auditor shall formulate an Overall audit strategy that sets the scope, timing and direction of the audit.***

The overall audit strategy guides the development of the audit plan.

5.4 ***In formulating the Overall audit strategy, the Cost Auditor shall consider all relevant factors.***

These relevant factors include:

(a) results of preliminary activities as specified in 5.1 above
(b) knowledge from previous audits and other engagements with the auditee
(c) knowledge of business
(d) nature and scope of the audit
(e) statutory deadlines and reporting format
(f) relevant factors determining the direction of the audit efforts

(g) nature, timing and extent of resources required for the audit.

5.5 ***The Cost Auditor shall develop an audit plan. The audit plan will include the nature, extent and timing of risk assessment, audit procedures and other activities.***

5.6 ***The Cost Auditor shall plan the nature, extent and timing of the direction and supervision of audit team members and the review of their work.***

5.7 ***The Cost Auditor shall update the Overall audit strategy and the audit plan as required during the course of audit.***

5.8 ***The Cost Auditor shall document the overall audit strategy, the audit plan and any significant changes made therein during the audit engagements and the reasons for the changes.***

5.9 ***In the initial audit, the Cost Auditor shall perform procedures regarding the acceptance of the client relationship and the specific audit. In case where the audit of the entity for the prior period was conducted by a different audit firm, the auditor shall communicate with the previous auditor.***

The subsequent paragraphs explain the requirements of SCA-101 alongwith the application guidance contained therein and detailed explanations: The purpose of this section to provide the logical understanding of the requirements and its interrelation with other SCA's (if any).

Requirement of SCA-101

5.1 ***Prior to entering the planning phase, the Cost Auditor shall ensure that:***

(a) ***the appointment as cost auditor is proper, he has received the letter of appointment and legal formalities regarding his appointment have been complied with;***

(b) ***the ethical requirements as per the regulations continue to be satisfied; (Refer 6.3)***

(c) ***an understanding of the terms of reference including the units to be covered, products/services to be covered, scope of coverage where the regulations leave it to be agreed between the auditor and the auditee.***

Application Guidance of SCA-101

6.3 Prior to the performance of other significant activities for the current year's audit, the auditor shall ensure that {Refer 5.1 (b)}:

(a) After the Cost Auditor has accepted the appointment for an entity, there are no changes in his position in relation to the entity that impede his arm's length relationship with the entity. Such as, acceptance of an assignment relating to designing and implementation of cost accounting system for the entity.

(b) Subsequent to his acceptance of the assignment, no issues about management integrity has cropped up that may affect the auditor's willingness to continue the engagement.

With reference to above requirement of Para 5.1 of SCA-101 and it's interrelated application guidance under 6.3 require to undertake the following **activities at the beginning of the audit engagement**;

- Letter of Appointment/Engagement
- Ethical Requirements
- Establishing and understanding terms of engagement in accordance with SCA 105

Letter of Appointment/Engagement

The cost auditor should agree to the terms of the cost audit engagement that shall be recorded in the engagement letter. The cost auditor should obtain formal letter of his appointment for the period mentioning the period, nature, and scope of cost audit engagement. The preconditions of accepting / continuing any professional engagements have been set out in SCA-105. These are reproduced below:

"***Prior to acceptance of any engagement, the cost auditor, in order to establish whether the preconditions for an audit/professional assignment are present, shall:***

(a) Determine whether the cost reporting framework to be applied in the preparation of the cost statements is acceptable; and

(b) Obtain the agreement of management that it acknowledges and understands its responsibility:

(i) for the preparation and presentation of the cost statements in accordance with the applicable cost reporting framework that gives true and fair view of cost of production or cost of operations, cost of sales, and margin for each product or service or activity, produced or provided by the entity for the period under audit;

(ii) for selection and consistent applications of appropriate cost accounting policies;

(iii) for implementation of cost accounting standards issued by the Institute, alongwith proper explanation relating to any material departures from those cost accounting standards;

(iv) for such internal control as management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error; and

(v) To provide the cost auditor with:

(a) Access to all information of which management is aware that is relevant to the preparation/audit/review etc of the cost statements such as records, documentation and other matters;

(b) Additional information that the cost auditor may request from management for the relevant purpose; and

(c) Unrestricted access to persons within the entity from whom the cost auditor determines it necessary to obtain audit evidence."

Therefore, the first and foremost step in cost audit is the appointment of cost auditor by the entity and cost auditor should necessarily ensure that all the relevant pre-conditions of an audit of cost statements as laid down in SCA-105 are met and the appointment is as per the Companies Act, 2013 and Rules provided thereunder. In this regard, the cost auditor should ensure the following:

a. The cost auditor (Proprietor /Firm) shall ensure that the consent letter from the cost auditor / firm is sent to the company that has finalized the appointment after the initial discussions and agreement of the terms and conditions amongst the entity and Cost Auditor.

b. The cost auditor shall ensure that the form CRA 2 is filed depicting the correct product CETA code and also mention correctly on the form whether it is under ***regulated / non-regulated*** industry. It shall also specify number of products under reference at CETA heading.

c. The cost auditor shall prepare the records of the meetings held with the company in connection with the appointment of the cost auditor regarding the scope of the audit with particular reference to the products/services/units to be covered under the audit of cost statement.

d. The cost auditor shall also take care that no other assignment would be included in the scope except the cost audit as per the guidelines given by the Institute of Cost Accountants of India, the Companies Act, 2013 and Rules & Regulations made thereunder.

e. Special care shall be taken to clearly specify that the preparation of Cost Statements is the responsibility of the entity and the cost auditor would perform the cost audit procedures, express his opinion on the position of cost statements under audit, and issue the Cost Audit Report.

f. In the event of the entity's cost records being audited for the first time (initial audit either for the first time or there is a change of cost auditor), the following information shall be obtained:

1. Memorandum and Articles of Association
2. Annual Reports of the previous three years
3. List of the key Management officials with their contact details
4. Details of the PAN, CENVAT, VAT and other important registrations under the applicable Acts and Rules
5. The process flow chart / cost flow chart
6. MIS, budgets and forecast reports

If management or those charged with governance impose a limitation on the scope of the cost auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the cost auditor disclaiming an opinion on the cost statements, the cost auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

If the preconditions for an audit/professional assignment are not present, the cost auditor shall discuss the matter with management. Unless required by law or regulation to do so, the cost auditor shall not accept the proposed audit engagement:

(a) If the cost auditor assesses that the cost reporting framework to be applied in the preparation of the cost, is unacceptable, or

(b) If the agreement has not been concluded.

The form and content of the cost audit engagement letter may vary for each entity. Information included in the cost audit engagement letter on the cost auditor's responsibilities may be based on standard on cost auditing 103. An example of a cost audit engagement letter as set out in Appendix-I of SCA -105 is given as Appendix – VI of this document for guidance of members and other stakeholders.

Ethical Requirements

The cost auditor or firm, its partner or the team leader responsible for the assignment should ensure whether members of the audit team have complied with relevant ethical requirements. It is recommended that ethical requirements may be fulfilled by the following:

(a) Methods and processes for establishing, promoting, and monitoring ethical conduct among all personnel.

(b) Policies and procedures to identify non-compliance with ethical requirements and to document both the issues identified and how they were resolved.

(c) Ethical requirements include:

(i) Independence;
(ii) Integrity;
(iii) Objectivity;
(iv) Professional competence and due care;
(v) Confidentiality;
(vi) Professional conduct; and
(vii) Technical standards

Each of the aforesaid ethical requirements has been further explained in the forthcoming paragraphs.

Independence

In case of cost auditors, the independence of the auditing entity is not only a requirement but an essential feature of the audit engagements. The concept of "arms length" relationship in its letter and spirit is absolutely necessary. In view of this, substantive changes have been made in the procedure for appointment of cost auditors under Companies Act, 2013.

Notwithstanding the recent developments, since transparency, accountability and independence of the a cost auditor are considered very important determinants of good enterprise governance; therefore, auditee should have the cost auditor's report as tool for better evaluation of the company's performance & risk management.

The cost auditor should assess the independence requirements which apply to the cost audit assignment. In this regard, the independence policy issues are:

(a) Policies and procedures to identify and evaluate circumstances and relationships that create threats to independence so that appropriate action may be taken to eliminate or reduce the threat to an acceptable level by applying safeguards or, if considered appropriate, by withdrawing from the engagement.

(b) Policies and procedures required to ensure compliance with the cost auditor's independence requirements of the relevant laws & rules.

(c) Requirements for engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable it to evaluate the overall impact, if any, on independence requirements of accepting or continuing with an engagement.

(d) Requirements for the engagement partner to obtain information, consider breaches if any of the firm's independence policies, take appropriate action and document conclusions on compliance with independence requirements that apply to the audit engagement.

(e) Requirements for personnel to promptly notify the firm of circumstances and relationships that creates a threat to independence so that appropriate action may be taken.

(f) Maintenance of adequate records to identify, communicate, and monitor compliance with, specific independence requirements (e.g., prohibited investment lists) so that appropriate action can be taken regarding identified threats to independence.

(g) Policies and procedures to provide the cost auditor with reasonable assurance that it is notified of breaches of independence requirements so that it may take appropriate action to resolve such situations.

(h) Processes in place to evaluate the appropriateness of undertaking non-assurance services for cost audit clients.

(i) Policies and procedures to reduce the familiarity threat including rotation of individuals with a significant role in a listed company audit engagement and limitations on employment of former partners, directors or lead auditors by audit clients or their related companies.

(j) Policies concerning fees and pricing (including fees that constitute a significant proportion of the firm's fees, overdue fees and pricing in proposals).

(k) Disciplinary procedures regarding non-compliance with independence policies and procedures.

(l) Policies when there is actual or threatened litigation between the firm and an auditee.

(m) Policies and practices when independence is determined to be impaired including reporting to any regulatory authority where required.

(n) Policies and procedures regarding communication with the audit committee / board of directors of an auditee including provision of information to the entity allowing adequate disclosure of non-audit services in the director's report or any other document for disclosure.

Integrity

While carrying out the cost audit assignments, cost auditor should ascertain the integrity aspects of the entity / client. This is particularly applicable in case of new clients though such period assessment may also be carried in case of existing clients.

Integrity is associated with soundness or moral principles and character in dealings with others. For assessing and evaluating the integrity the following aspects of the client may be considered-

(a) The identity, business reputation and attitude of the owners and key management personnel and related parties.

(b) The nature of the client's operations, including its business practices.

(c) Attitude of the management towards compliance of various statutory requirements including implementation of cost accounting standards, the internal control systems, internal audit etc.

(d) Limitations suggested / imposed on the scope of work.

(e) The reasons for the proposed appointment of the cost auditor and non reappointment of the previous firm.

Objectivity

The test of objectivity shall be whether the cost audit was carried out in an impartial and fair manner without favour or prejudice. The cost auditor should base his assessment and opinion purely on facts, audit evidences and on sound analysis.

Professional Competence and due care

A cost auditor should take due care in reporting and authenticating cost statements applying his professional skills and maintaining objectivity and integrity. While exercising due care and reflecting professional competence, cost auditor should possess:

(a) an understanding of cost auditing and other standards applicable to fulfil the auditor' responsibilities in the audit;

(b) special skills (for example, industry specific knowledge) necessary to perform the work on the cost information of the particular component; and

(c) an understanding of the applicable cost/financial reporting framework that is sufficient to fulfil the cost auditor's responsibilities.

Confidentiality

Confidentiality is the heart of cost and management accountancy profession and as a professional, complete confidentiality of information obtained during cost audit assignment is the basic requirement.

Relevant ethical requirements establish an obligation for the cost auditor to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or there is a legal or professional duty to do so.

Professional Conduct

Cost accountants are looked upon as trustworthy guardians caring for consumer protection, investor protection, guides to corporate world in cost leadership. As corollary their professional conduct must also be illustrative and above board.

As professionals in the field of Cost and Management Accounting, the members of the Institute of Cost and Works Accountants of India are bound by a code of professional ethics. This code stipulates and binds cost accountants to the highest level of care, duty and responsibility to their employers and clients, the public and their fellow professionals.

Technical Standards

The cost auditor should be fully conversant with various pronouncements by the cost accounting / accounting regulatory bodies and other bodies and should keep updated with the technical standards which may be prescribed from time to time.

TERMS OF REFERENCE

The auditor shall agree to the terms of audit engagement with the management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include [*refer para 5.5 of SCA-105*]:

(a) The objective and scope of the audit of the cost/financial statements;

(b) The responsibilities of the firm;

(c) The responsibilities of management;

(d) Identification of the applicable financial reporting framework for the preparation of the cost/ financial statements; and

(e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

When relevant, the following points could also be made in the cost audit engagement letter [*refer para 6.2 of SCA-105*]:

(a) Arrangements concerning the involvement of other cost auditors and experts in some aspects of the cost audit.

(b) Arrangements concerning the involvement of internal auditors and other staff of the entity.

(c) Arrangements to be made with the previous cost auditor, if any.

(d) Any restriction of the cost auditor's liability when such possibility exists.

(e) A reference to any further agreements between the cost auditor and the entity.

(f) Any obligations to provide cost audit working papers to other parties.

5.2 The audit partner and other key members of an audit team shall be involved in planning the audit, including planning and participating in the discussion among audit team members.

6.4 The involvement of the audit partner and other key members of the audit team in planning the audit draws on their experience and insights, thereby enhancing the effectiveness and efficiency of the planning process)

Para 5.2 and its application guidance under para 6.4 of SCA-101 require to get engagement partner and other key members of the engagement team to get involved in Planning and Discussion to enhance the effectiveness and efficiency of the planning process by using their experience and insights.

PLANNING

Planning is crucial to a successful audit engagement because it enables auditors to meet their professional responsibilities.

Planning an audit is one of the most integral part of the audit. Without an adequate programme of planning by the cost auditor, there is wide scope for a material misstatement (or multiple material misstatements) to be missed, resulting in the expression of an incorrect audit opinion by the cost auditor as well as other repercussions. Planning takes place before the start of an audit engagement and must never be seen as a stand-alone part of the cost audit and may need revision as the cost audit progress.

Planning activities for a new audit engagement will often be more in depth than for a recurring engagement because the cost auditor will not have previous experience of the audit engagement with the said entity, and, therefore, the cost auditor will need to develop an understanding of the entity and the environment in which it operates to comply with the provisions of SCA -117.

Planning includes identifying audit risk while obtaining the understanding of the business, assessing the identified risk and responding to audit risks by designing the adequate audit procedures and applying them to obtain sufficient appropriate audit evidence to bring down the audit risk to an acceptable level. Planning also includes consideration of materiality and application of analytical procedures.

Planning consists of:

(a) Developing an overall audit strategy
(b) Overall Audit Plan to lead to the preparation of detailed audit programme

To develop the above documents the auditor needs to perform certain initial activities;

(i) Initial meeting with the client
(ii) Risk assessment procedures

DISCUSSION

An engagement team discussion is often held at the start of the planning work where the team will look at the completion side of the previous audit, review unadjusted errors, discuss any control deficiencies that they noted during the previous year's detailed audit work and a summary of matters that were discussed with management and, where applicable, those charged with governance, during the previous audit. A critical element in the success of any audit engagement is good communication among the audit team members.

SCA-109, enlist the following matters that may include for discussion among audit team:

- An exchange of ideas among audit team members about how and where they believe the entity's cost statements may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent cost reporting, and how assets of the entity could be misappropriated.

- A consideration on analysing the budgets, forecasts, variance analysis, key ratios etc.

- A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent cost reporting.
- A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.
- An emphasis on the importance of maintaining a proper state of mind throughout the cost audit regarding the potential for material misstatement due to fraud.
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the cost audit procedures to be performed.
- A consideration of the cost audit procedures that might be selected to respond to the susceptibility of the entity's cost statement to material misstatement due to fraud and whether certain types of cost audit procedures are more effective than others.
- A consideration of any allegations of fraud that have come to the cost auditor's attention.
- A consideration of the risk of management override of controls.

SCA-117 states the following matters for discussion among the audit team about the susceptibility of the entity's cost statements to material misstatement:

- Provides an opportunity for more experienced audit team members, including the audit partner, to share their insights based on their knowledge of the entity.
- Allows the audit team members to exchange information about the business risks to which the entity is subject and about how and where the cost statements might be susceptible to material misstatement due to fraud or error.
- Assists the audit team members to gain a better understanding of the potential for material misstatement of the cost statements in the specific areas assigned to them, and to understand how the results of the audit procedures that they perform may affect other aspects of the audit including the decisions about the nature, timing and extent of further audit procedures.

- Provides a basis upon which audit team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks.
- It is not always necessary or practical for the discussion to include all members in a single discussion (as, for example, in a multi-location audit), nor is it necessary for all of the members of the audit team to be informed of all of the decisions reached in the discussion.
- The audit partner may discuss matters with key members of the audit team including, if considered appropriate, those with specific skills or knowledge, and those responsible for the audits of components, while delegating discussion with others, taking account of the extent of communication considered necessary throughout the audit team. A communications plan, agreed by the audit partner, may be useful.

The following exhibit summarizes what to consider and discuss among the audit team communications.

Assigning team members and roles

Consider:

- Skills and experience
- Need for experts
- Need for engagement quality control reviewer

Audit planning meeting

Discuss:

- Materiality
- Insight based on knowledge of entity.
- Potential business and fraud risks
- How/ where cost statements might be susceptible to material misstatement
- Audit plan including who, what, where & when
- Supervision and review

During and after the cost audit

Discuss:

- Audit results, progress, and issues identified
- Changes in audit plan
- New information available
- Unusual events/ Transactions during the audit of cost statements
- Suggestions for next period's audit of cost statements

5.3 The Cost Auditor shall formulate an Overall audit strategy that sets the scope, timing and direction of the audit.

5.4 In formulating the Overall audit strategy, the Cost Auditor shall consider all relevant factors.

These relevant factors include:

(a) results of preliminary activities
(b) knowledge from previous audits and other engagements with the auditee
(c) knowledge of business
(d) nature and scope of the audit
(e) statutory deadlines and reporting format
(f) relevant factors determining the direction of the audit efforts
(g) nature, timing and extent of resources required for the audit.

Developing an audit strategy involves:

1) The identification of the characteristics of the cost audit engagement which defines its scope;
2) Determining the reporting objectives of the cost audit engagement and planning the timing and nature of the cost audit;
3) Determining the factors that, in the cost auditor's professional judgement, are classed as 'significant' and to which the audit team should direct efforts;
4) Considering the results of the preliminary audit engagement activities and whether knowledge gained on the other cost audit engagements by the audit engagement partner is relevant; and
5) Determining the nature, timing and extent of resources needed to perform the cost audit engagement.

These requirements are discussed in detail in Chapter – 5 **"Audit Strategy"**

5.5 ***The Cost Auditor shall develop an audit plan.***
The audit plan will include the nature, extent and timing of risk assessment, audit procedures and other activities.

6.6 The audit plan is more detailed than the overall audit strategy as it includes the nature, timing and extent of audit procedures to be performed by audit team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. (Refer5.5)

Para 5.5 and its interrelated application guidance require to develop **audit plan** that involve;

- The nature, timing and extent of planned risk assessment procedures, as determined under SCA 117;
- The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SCA 118; and
- Other planned audit procedures that are required to be carried out so that the engagement complies with all other related SCAs

This requirement is discussed in detail in Chapter – 6 **"Audit Plan"**

5.6 The Cost Auditor shall plan the nature, extent and timing of the direction and supervision of audit team members and the review of their work. (Refer 6.7)

6.7 The nature, extent and timing of the direction and supervision of audit team members and review of their work vary depending on, among others, the size and complexity of the entities activities, risk assessment results and the capabilities and competence of the individual team members performing the audit work.

Para 6.1 states that the nature and extent of planning activities will vary according to the:

(a) size and complexity of the entity's activities, the number of products to be covered, the processes and operations involved.

(b) the audit team members' previous experience with the entity and the industry.

(c) changes in circumstances that occur during the audit.

However, evidently without adequate direction and supervision of audit team and review processes, there is a significant risk that the audit evidence gathered will not be sufficient or appropriate to comply with SCA-107 Audit Evidence.

This requirement is discussed in detail in Chapter – 6 **"Audit Plan"**

5.7 The Cost Auditor shall update the Overall audit strategy and the audit plan as required during the course of audit. (Refer 6.8)

6.8 As a result of unexpected events, changes in conditions or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan.

In order for a plan to be effective, it needs to be dynamic, iterative and flexible to address any changed circumstance. As all matters cannot be predicted in advance, rigid adherence to the pre-determined plan without adjusting for necessary amendments will not support accomplishment of audit objectives.

The amendments to the overall audit strategy and plan (with consequential effect on nature, timing and extent of further audit procedures) may be required on account of:-

- Unanticipated events
- Changed conditions
- Inconsistent information
- Divergence noted between the expected audit evidence and the actual evidence

This requirement is discussed in detail in Chapter – 6 **"Audit Plan"**

5.8 The Cost Auditor shall document the Overall audit strategy, the audit plan any significant changes made therein during the audit engagements and the reasons for the changes.

Para 5.7 and its interrelated application guidance in Para 6.8 require to document the overall audit strategy, audit plan and any significant changes.

The audit documentation should be such that an experienced auditor, who had no previous connection with the audit, is able to understand the details of audit procedures conducted during the audit of cost statements and basis of forming opinion and cost audit report.

Good audit documentation is appropriately organized, and provides a record of the work done, the audit evidence obtained, the significant professional judgments applied, and the conclusions reached.

This requirement is discussed in detail in Chapter – 7 **"Documentation"**

5.9 In the initial audit, the Cost Auditor shall perform procedures regarding acceptance of the client relationship and the specific audit.

In case where the audit of the entity for the prior period was conducted by a different audit firm, the auditor shall communicate with previous auditor (Refer 6.9)

6.9 Additional Consideration in Initial Audit Engagements: The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For the initial audit, additional matters the auditor may consider in formulating the overall audit strategy and audit plan include the following.

(a) The planning activities may expand to cover consultations with the previous auditor, review of previous year's audit working papers, if not prohibited by other Law or regulation, and previous year's transactions having an impact on current year's cost.

(b) Any major issues (including the application of cost accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as cost auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.

(c) The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (such as Inventory).

(d) Other procedures required by the firm's system of quality control for initial cost audit engagements (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).

- Para 5.9 with its interrelated application guidance require that In respect of **Initial Audit Engagement;**
  - Performing procedures regarding the acceptance of the client relationship and the specific audit engagement; and
  - Communicating with the predecessor auditor, where there has been a change of auditors, in compliance with relevant ethical requirements.

The cost auditor is generally more careful about accepting the new client because of lack of previous experience with the management and those charged with the governance and knowledge of the business, transactions and associated risks affecting the cost statements. While certain assessment procedures for both the prospective and existing clients would be common, however, they may assume additional importance in case of a new client.

Client Acceptance and Continuance

Client acceptance and continuance encompasses both deciding on acquiring a new client or continuation of relationship with an existing one and the type and amount of staff required. The cost auditor should establish policies and procedures for the acceptance and continuance of client relationships. Typical policies and procedures involved in this process are:

1. Evaluate the client's background;
2. Determine whether the cost auditor is able to meet the ethical requirements regarding the client;
3. Communicate with the previous auditor;
4. Determine need for other cost auditor's experts;
5. Select audit team to perform the audit; and
6. Obtain an engagement letter.

Initial Audit / New Client

This can happen when the auditee has come under the scope of cost audit for the first time or the audit firm is being replaced. In either case, the audit team will take enhanced time to understand the nature of the business and standards of the accounting and management practices.

Whenever it is the case of the company coming under the purview of the cost audit for the first time, the cost auditor should appraise and enlighten the client about the cost audit and also the maintenance of cost records etc., as per the Cost Accounting Standards issued by the Institute of Cost Accountants of India. In this case enhanced audit procedures may be required to be followed by the Cost Auditor to ensure that the cost statements comply with the applicable law & regulations.

Prior to accepting a new client, the cost auditor should obtain knowledge about the client. The cost auditor should evaluate the client's standing in the business community, financial stability and operating performance, and relations with its previous cost auditor. The main purpose is to ascertain the integrity of the client and the possibility of misstatement due to error or fraud. The cost auditor should be especially concerned with the possibility of fraudulent cost reporting framework since it is difficult to uncover. If the client has been audited previously, the new cost auditor should contact the previous cost auditor, in order to evaluate whether to accept the cost audit engagement. The previous cost auditor should respond to the new cost auditor's request for information subject to compliance with relevant ethical requirements.

Continuing Clients

On recurring cost audits, the cost auditor shall assess whether circumstances require the terms of the cost audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the cost audit engagement. The cost auditor may decide not to send a new cost audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the cost audit engagement or to remind the entity of existing terms:

(i) Any indication that the entity misunderstands the objective and scope of the cost audit

(ii) Any revised or special terms of the cost audit engagement

(iii) A recent change of senior management

(iv) A significant change in ownership

(v) A significant change in nature or size of the entity's business

(vi) A change in legal or regulatory requirements

(vii) A change in the cost reporting framework adopted in the preparation of the cost statements

(viii) A change in other reporting requirements

An illustrative prospective Client Acceptance / Existing Client's Continuation Memorandum is provided as Appendix –

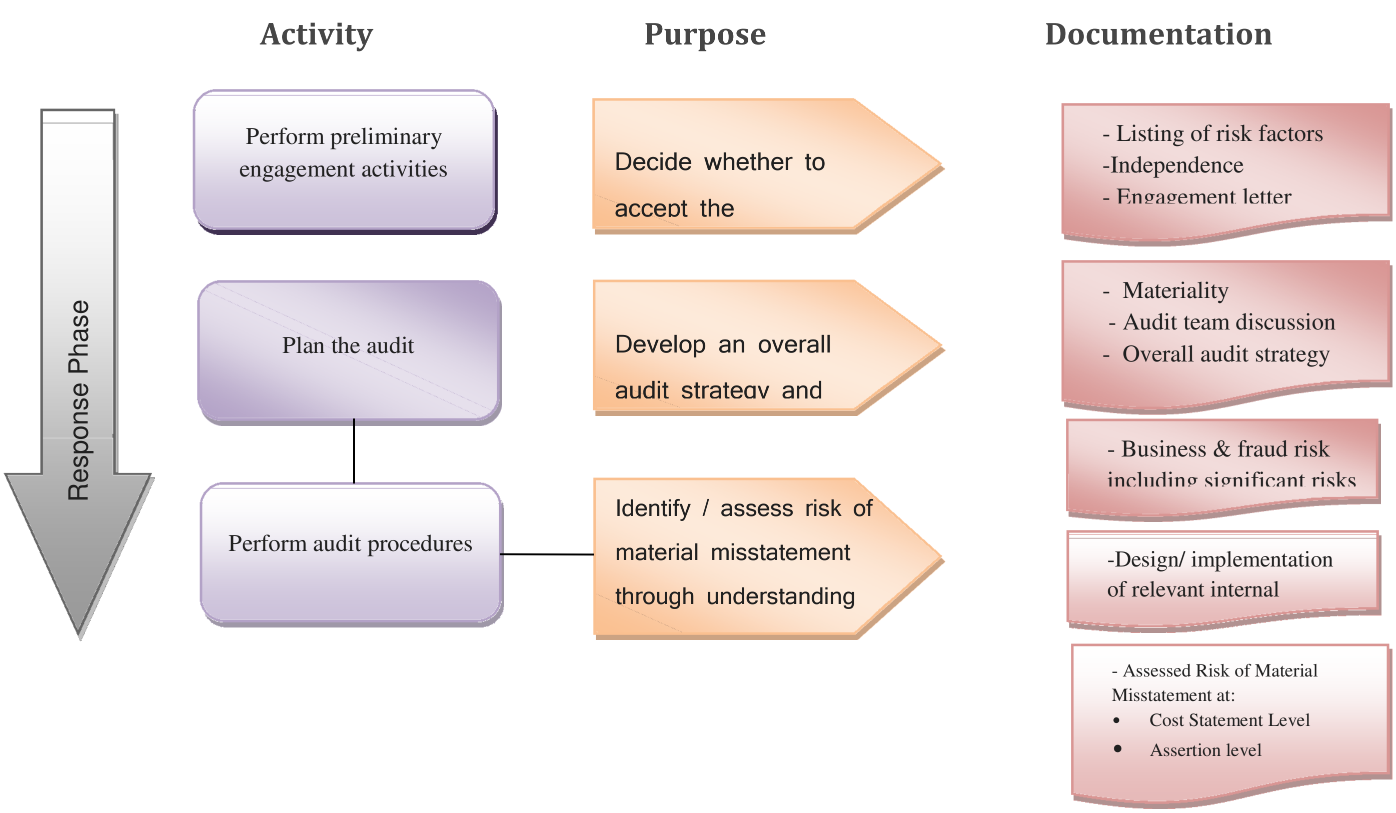
CHAPTER –5 AUDIT STRATEGY

INTRODUCTION

The overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team. In order to take the right decisions, the auditor shall perform certain preliminary engagement activities at the commencement of the current audit engagement to identify and evaluate events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement. Further, certain additional considerations are required for an initial engagement as compared to a continuing engagement.

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

The audit strategy sets out in general terms how the audit is to be conducted and sets the scope, timing and direction of the audit. The audit strategy then guides the development of the audit plan, which contains the detailed responses to the auditor's risk assessment. An underpinning principle of audit planning is that the audit plan should contain detailed responses to the specific risks identified from obtaining an understanding of the audited entity.



5.3 The Cost Auditor shall formulate an Overall audit strategy that sets the scope, timing and direction of the audit.

The overall audit strategy guides the development of the audit plan.

Developing an audit strategy involves:

1) **Identification of characteristics of cost audit engagement:** Some audit engagements have specific characteristics that wider the scope than audit of a small entity having single product. For example, a lead auditor engagement or the audit of multi location facilities of a company engaged in production of multiple products or rendering multi-faceted services will have wider scope than an audit of a small entity with one unit & one product. Other matters such as the IT environment, complexity of operations, specific regulatory requirements, need of experts, etc. are also relevant.

2) **Determining the reporting objectives of the engagement:** Reporting requirements may vary from audit to audit. For example, some entities have additional reporting requirements to comply with law and regulations by regulator or industry requirements, and the cost auditor must understand these requirements from the start of the cost audit.

3) **Planning the timing and nature of audit communications:** The nature of communications that may be necessary during the audit should be considered, such as liaison with other auditors, cost auditor' expert, communications with management and with those charged with governance.

4) **Determining the factors to which the audit team should direct their efforts:** The audit strategy must consider issues to do with quality of audit and control, such as how resources are managed, directed and supervised. When team briefing and debriefing meetings are to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site).

5) **Determining the factors that, in the cost auditor's professional judgement, are classed as 'significant':** The significant matters are:

   - Nature of the Industry – priority industry, export oriented industry etc.
   - Production Method / Process
   - Important raw Material and their sources. BOM, Power, Gas, Fuel
   - Licensed capacity and installed capacity
   - Method of costing in use

- Cost reporting framework / Cost accounting policies adopted
- Method of accounting of raw materials, stores and finished goods
- Method of accounting of wastages, spoilage and rejections
- Method of allocation , assignment and absorption of cost
- Records relating to jigs, moulds and dies
- System of wages, salaries and other employee's benefits
- Basis of allocation of overheads
- Method of allocation of service department expenses
- Method of accounting of depreciation, revaluation loss or impairment of assets
- Agreement with collaborators or other for payments of royalty, its computation and payment
- Accounting for sales and purchases – treatment of indirect taxes
- Method of accounting of credit, recoveries, subsidies or grant
- System of year-end stock taking
- Method determination of work in progress
- Inventory valuation policy and method of calculation of net realisation value
- Systems of budgetary control
- Contemporary Management tools and techniques i.e. kaizen, lean accounting, Just-in-time inventory, Target Costing, Transfer Pricing Policy
- System of internal control, internal audit reports
- State of internal control over cost accounts and cost accounting records
- Cost accounting manual, if any
- Special cost accounting practices and methods peculiar to the industry under audit
- Treatment of Revenue
- Captive consumption of goods or services
- Generation of Power or other gas or fuel and its accounting
- Variance analysis

6) **Considering the results of preliminary audit engagement activities:** This includes the initial assessments of materiality, risks identified from preliminary activities such as fraud risks, significant events that have occurred at the entity or in the industry in which it operates since the last audit, and the results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them. The audit firm may also have performed other services for the client that may be relevant in determining the audit strategy, for example, benchmarking, capacity determination or price forecasting.

7) **Determining the nature, timing and extent of resources needed to perform the cost audit engagement:** One of the main objectives of developing the audit strategy is to effectively allocate resources to the audit team, for example, the use of specialists on

particular areas of the audit, or building a team of highly experienced auditors for a potentially high-risk audit engagement. If the audit is time pressured due to tight deadline, then more resources will need to be allocated to ensure that all necessary audit work is completed, and can be reviewed in time to meet the deadline.

5.4 In formulating the Overall audit strategy, the Cost Auditor shall consider all relevant factors. (Refer 6.5) These relevant factors include:

(a) results of preliminary activities
(b) knowledge from previous audits and other engagements with the auditee
(c) knowledge of business
(d) nature and scope of the audit
(e) statutory deadlines and reporting format
(f) relevant factors determining the direction of the audit efforts
(g) nature, timing and extent of resources required for the audit.

6.5 Matters that are relevant in formulating the overall audit strategy and drawing up the audit plan include, in addition to those mentioned earlier, the following (Refer 5.4, 5.5):

(a) The cost reporting framework generally prescribed, under the Companies Act and Rules prescribed thereunder, as well as under any other law as applicable, on the basis of which the cost information to be audited has been prepared, including need for reconciliation with financial reporting framework.

(b) Industry regulators' requirement as to how costs will be treated.

(c) Unique features of an industry that influence audit requirements such as definition of product in the newspaper industry.

(d) Reliance that can be placed on the work of other auditors and internal auditors. such as their role as branch auditor or lead auditor.

(e) State of IT (Information Technology) implementation, whether the entity is using an ERP (Enterprise Resource Planning) system or internally developed systems and the reliance that can be placed on them.

(f) Statutory timelines for cost reporting, which can be modified by the management for early completion.

(g) Timelines for Board/ audit committee meetings, which can set the time limits for

For formulating the audit strategy, the cost auditor should take the following practical aspects:

1. **Self-appraisal of the knowledge of operations:** This phase may require more interaction with the officials of the company at various levels. More relevance requires on adequate and functional knowledge of the operational areas that includes:

   - Number of products / units and locations

- Joint products/ by-products/scrap/wastages
- Input to Output norms / ratios
- Trend Analysis- Consumption, Wastages, Production and Contribution, Power and Fuel, Man Hours, Machine Hours, Overhead Rates.
- Power consumption and cost per unit of power consumed
- Material storage
- Process flows – Routing and Cost Flow and Benchmarking
- Technology up-gradation, obsolescence or changes (if any)
- Working capital
- Capacity utilization
- Industry regulators' requirement as to how costs will be handled
- Unique features of an industry that influence audit requirements.
- Other important aspects specific to the industry

2. Extent of reliance that can be placed on the work of other auditors, branch or unit cost auditors appointed by the entity and internal auditors.

3. Consultation with the previous cost auditor to understand and take a view of the impact of the previous year that may creep into the current year's audit.

4. Statutory time lines for cost reporting, management responsibilities and expectations.

5. Timelines for cost audit/board/ audit committee meetings which can set the priority for completion of audit work.

6. Any special / additional resources required to execute and complete the audit.

7. Operational issues noticed during the risk assessment phase.

8. Extent and level of cooperation / support provided by the officials of the auditee.

(i) If the company is implementing a new ERP system, the officials would not have been trained yet; this may cause passive response from them. The audit team may have to help them in solving the issues in the preparation of the report format templates and other associated constraints.

(ii) In some cases, switching over from manual or other accounting packages to ERP would be just happening. This would also have an impact on your audit strategy.

(iii) In the initial audit where the auditee is first time under the cost audit purview, the preparation of cost statements would be little critical as systems and controls yet to get stabilized. It needs initial counselling from the cost auditor.

5.7 The Cost Auditor shall update the Overall audit strategy and the audit plan as required during the course of audit. (Refer 6.8)

6.8 As a result of unexpected events, changes in conditions or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan.

In order for a plan to be effective, it needs to be dynamic, iterative and flexible to address any changed circumstance. As all matters cannot be predicted in advance, rigid adherence to the pre-determined plan without adjusting for necessary amendments will not support accomplishment of audit objectives.

The amendments to the overall audit strategy and plan (with consequential effect on nature, timing and extent of further audit procedures) may be required on account of:-

- Unanticipated events
- Changed conditions
- Inconsistent information
- Divergence noted between the expected audit evidence and the actual evidence

Consideration in up-gradation or revision of the Overall Audit Strategy

The following considerations provide examples of matters the cost auditor may consider in establishing the overall audit strategy as well as up-gradation and revision thereof as the audit progresses. Many of these matters may also influence the auditor's detailed audit plan. The examples provided cover broad range of matters applicable to many engagements; the list is not necessarily complete.

Characteristics of Engagement

- The cost reporting framework showing the cost information to be audited, including any need for reconciliation with another reporting framework. For example, reconciliation with financial statements or reconciliation of statement of indirect taxes with other indirect tax returns /audit reports

- Industry specific reporting requirements as may be mandated by industry regulators i.e. Power Industry, Telecom Industry

- The expected audit coverage, including the number and locations of units / plants to be included. i.e. multi locations or multi product or both

- Nature of relationship among various production/service units that determines how the cost statements as a whole are to be prepared i.e. captive consumption, inter-unit transfer pricing
- The extent to which units are audited by other cost auditor(s)
- The nature of operations / business segments to be audited, including the need for specialized knowledge i.e. mining or shipping
- Whether the entity has internal audit functions and if so, whether, in which areas and to what extent, the work of function can be used, or internal auditors can be used to provide direct assistance, for the purpose of cost audit i.e. process / performance audit report by internal auditor
- The entity's use of service organization and how the cost auditor may obtain evidence concerning the design or operations performed by them i.e. technical know-how or software support
- The expected use of audit evidence obtained in previous audit, i.e. audit evidence related to risk assessment procedures and test of controls
- The effect of information technology on the cost audit procedures, including the availability of data and the expected use i.e. computer assisted audit techniques
- The coordination of the expected coverage and timing of audit work with any review on interim cost statements and the effect of audit of the information obtained during such review i.e. significant change in key ratios

Reporting Objectives, Timing of Cost Audit, and Nature of Communications

- The entity's schedule for cost reporting framework i.e. Interim or Final Cost reporting framework
- Organization of meetings with management to discuss the nature, timing and extent of audit work i.e. pre-engagement meetings, interim meetings to obtain understanding or discussion on cost audit finding's and final meeting before forming an audit opinion.
- Discussion with management regarding the expected timing of reports to be issued and other communications, both written and oral i.e. Cost Audit Report to Board of Directors / Audit Committee
- Communication with cost auditors of units regarding timing of reports to be issued and other communications.

- Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of audit work done, i.e. review of audit procedures performed.

- Any other expected communications with third parties, i.e. job worker, third party stock confirmation, loss in transit confirmation etc.

Significant Factors, Preliminary Engagements Activities and Knowledge Gained on other Engagements

- The determination of materiality in accordance with SCA-108 and, where applicable:
  - determination of materiality for units and communication thereof to branch cost auditor.
  - preliminary identification of significant components and material classes of transactions, cost heads, items of cost and disclosures.

- Preliminary identification of area where there may be a higher risk of material misstatements i.e. BOM cost, inventory valuation, overheads-basis of apportionment, recognition of revenue, etc.

- Likely impact of assessed risk of material misstatement at the overall cost statement level

- Manner in which the cost auditor emphasizes to his engagement team members regarding the need to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence i.e. skepticism regarding key ratios, overhead rates, etc.

- Results of previous audit that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and the action taken to address them i.e. incorrect classification of items of cost or lack of operating controls

- Evidence of management's commitment to design, implement, and maintain sound internal control systems, including evidence of appropriate documentation of such internal controls. For example, lack of control for effective usage of delegated authority

- Effectiveness of internal control systems commensurate with the scale of operations - whether the cost auditor can rely on.

- Significant business developments affecting the entity, including changes in information technology and business processes, changes in key management, i.e. diversification of business or new product or portfolio introduced to business.

- Significant industry developments such as changes in industry regulations and new reporting requirements.
- Significant changes in the cost accounting policy / accounting policy that may affect the cost reporting framework i.e. adoption of fair value estimates
- Other significant recent developments, such as changes in legal environment affecting the performance of entity i.e. changes in environmental law / policy.

CHAPTER – 6 AUDIT PLAN

The audit plan is more detailed than the overall audit strategy as it includes the nature, timing and extent of audit procedures to be performed by audit team. Once the overall audit strategy has been established, an audit plan can be developed to address the various issue identified in formulating overall audit strategy, taking into account to achieve the cost audit objectives through the efficient use of the cost auditor's resources and timely completion.

Let us understand the Audit Plan (Refer Para 4.3)

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

An Audit plan is the specific guideline to be followed when conducting an audit. It helps the auditor obtain sufficient appropriate evidence for the circumstances, helps keep audit costs at a reasonable level, and helps avoid misunderstandings with the client.

It addresses the specifics of what, where, who, when and how:

1. What are the objectives of audit of cost statements?
2. What audit procedures is to carried out?
3. Where will the audit be done? (i.e. scope)
4. When will the audit(s) occur? (How long, interim / final)
5. Who are the cost auditors?
6. How will audit of cost statements is to be done?

For the audit plan, standard audit programs and/or checklists drawn up on the assumption of few relevant control activities, may be used provided that they are tailored to the circumstances of the engagement, including the auditor's risk assessments.

5.5 ***The Cost Auditor shall develop an audit plan.***
The audit plan will include the nature, extent and timing of risk assessment, audit procedures and other activities.

6.6 The audit plan is more detailed than the overall audit strategy as it includes the nature, timing and extent of audit procedures to be performed by audit team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures.

5.6 The Cost Auditor shall plan the nature, extent and timing of the direction and supervision of audit team members and the review of their work. (Refer 6.7)

6.7 The nature, extent and timing of the direction and supervision of audit team members and review of their work vary depending on, among others, the size and complexity of the entities activities, risk assessment results and the capabilities and competence of the individual team members performing the audit work.

To sum up the requirements of 5.5 & 5.6 of SCA -101 for developing an audit plan that involve;

- The nature, timing and extent of planned risk assessment procedures, as determined under SCA 117;
- The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SCA 118; and
- Other planned audit procedures that are required to be carried out so that the engagement complies with all other related SCAs

SCA -117 states, the nature, timing and extent of planned risk assessment procedures are reproduced below;

The risk assessment procedures shall include the following:-

(a) ***Inquiries of management, of appropriate individuals within the internal audit function (if the function exists), and of others within the entity who in the cost auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error.***

(b) ***Analytical procedures***

(c) ***Observation and inspection***

The aforesaid risk assessment procedures have been further explained as under.

Inquires with Management

Much of the information obtained by the cost auditor's inquiries is from the management and those responsible for cost reporting. Information may also be obtained through inquiries with the internal audit function, if the entity has such a function within the entity.

The cost auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority. For example:

- Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the cost auditor to evaluate the appropriateness of the selection and application of certain cost accounting policies.
- Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity.
- Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- Inquiries directed to the risk management function (or those performing such roles) may provide information about operational and regulatory risks that may affect cost reporting.
- Inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system-related risks.

Analytical Procedures

Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the cost auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both costing and non-costing information. For example, relationship between overheads absorption and capacity utilisation.

Analytical procedures may help identify the existence of unusual or abnormal transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

Observation and Inspections

Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment. Examples of such audit procedures include observation or inspection of the following:

- The entity's operations
- Documents (such as business plans and strategies), records, and internal control manuals
- Reports prepared by management (such as quarterly management reports and interim cost statements) and those charged with governance (such as minutes of board of directors' meetings)
- The entity's premises and plant facilities

Eventually such risk assessment helps the cost auditor to determine whether any of the risks identified may potentially be a significant risk arising due to fraud; complexity of transactions; degree of subjectivity; unusual or extraordinary events or due to recent significant economic, accounting, or other developments.

The planning of the cost auditor's risk assessment procedures occurs early in the cost audit process. However, planning the nature, timing and extent of specific further audit procedures (as described in below paragraph) depends on the outcome of those risk assessment procedures. In addition, the cost auditor may begin the execution of further audit procedures for some cost heads, items of cost and disclosures before planning all remaining further audit procedures.

SCA-118 states the nature, timing, and extent of planned further audit procedures at the assertion level. These are reproduced below;

In designing the further audit procedures to be performed, the cost auditor shall:

(a) ***Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each items of cost in the cost statement, and disclosure, including:***

i. ***The likelihood of material misstatement due to the particular characteristics of the relevant items of cost in the cost statement, or disclosure (that is, the inherent risk); and***

ii. ***Whether the risk assessment takes account of relevant controls (that is, the control risk), thereby requiring the cost auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the cost auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); and***

(b) ***Obtain more persuasive audit evidence if the cost auditor's assessment of risk is higher.***

The three attributes nature, timing, and extent of planned audit procedures are explained below.

Nature

The nature of the audit procedures is fundamental to responding to audit risks and covers its type *(inspection, observation, inquiry, confirmation, recalculation, re-performance, etc.,)* and its purpose (*tests of controls or substantive procedures)*

The nature of procedures may depend on:

- **Assertions tested** – for example, in relation to audit of selling & distribution cost, tests of controls / substantive analytical procedures may be suitable to validate completeness assertion; tests of details may be necessary to validate accuracy/ ownership whereas observation may be appropriate for existence.
- **Level of risk** – Combination of audit procedures may be required to address certain elevated risks, for example, in relation to audit of consumption data, inspection of records for free supply materials received may be supplemented by external confirmation process.
- **Characteristics of items of cost** – If the assessed risks are lower based on the expectation of inherent internal control, tests of controls is a requisite procedure.

The cost auditor's assessed risks may affect both the types of audit procedures to be performed and their combination. For example, when an assessed risk is high, the auditor may confirm the completeness of the terms of a contract with the counterparty, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, while verifying the assessed risk of misstatement in material consumption in line with the Bill of material, the tests of controls and substantive procedures may be most responsive to assess the assertions made with respect to the completeness and accuracy.

Timing

The cost auditor may perform tests of controls or substantive procedures at an interim date or at the period end. The higher the risk of material misstatement, the more likely it is that the cost auditor may decide it is more effective to perform substantive procedures nearer to, or at, the period end rather than at an earlier date, or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of fraud. For example, the cost auditor may conclude that, when the risks of intentional misstatement or manipulation have been identified, audit procedures to extend audit conclusions from interim date to the period end would not be effective.

In addition, certain audit procedures can be performed only at or after the period end, for example:

(a) Agreeing the cost statements to the cost records;

(b) Examining adjustments made during the course of preparing the cost statements;

(c) 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;

(d) 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; and

(e) Statement of value addition and distribution of earnings.

Extent

This denotes the quantity of testing and is proportionately affected by the materiality levels and the degree of assurance the cost auditor's plans to obtain. For example, the cost auditor may plan to increase the sample size to have a greater coverage in response to heightened risks. However, the nature of controls may influence the extent of testing, for example, in respect of an automated controls, the sample size could be considerably lower since the attribute to be tested remains consistent throughout the population.

The extent of an audit procedure is determined after considering the materiality, the assessed risk, and the degree of assurance the cost auditor plans to obtain. When a single purpose is met by a combination of procedures, the extent of each procedure is considered separately. In general, the extent of audit procedures increases as the risk of material misstatement increases. For example, in response to the assessed risk of material misstatement due to fraud, increasing sample sizes or performing substantive analytical procedures at a more detailed level may be appropriate. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is relevant to the specific risk.

Other planned audit procedures

These are required to be carried out so that the engagement complies with all other related SCAs.

Substantive Procedures

Substantive procedures are performed by the cost auditor to gather evidence regarding the assertions that are embedded in the cost heads and underlying items of cost; and detect material misstatements. Typical substantive procedures include selection of an item of cost or a representative sample of transactions to:

- Recalculate recorded cost information for accuracy;
- Confirm existence of balances (stock lying with third party, inventory etc.);
- Ensure transactions are recorded in the right period (cut-off tests);
- Compare amounts between periods or with expectations (analytical procedures);
- Inspect supporting documentation (such as invoices or contracts);
- Observe physical existence of recorded assets (inventory); and
- Review the adequacy of allowances made for loss of value (abnormal losses).

Test of Details

Audit procedures designed to gather evidence that will substantiate cost statements, They are used to obtain audit evidence regarding assertions such as existence, accuracy and valuation.

Test of Controls

Tests of controls are performed by the auditor to gather evidence as to the operational effectiveness of internal control procedures to ensure that these address specific assertions where reliance on controls is planned; and prevent or detect/correct material errors or fraud from occurring. Typical tests of controls include the selection of a representative sample of transactions or supporting documentation to:

- Observe the operation of an internal control procedure being performed;
- Inspect evidence that the control procedure was performed;
- Inquire about how and when the procedure was performed; and
- Re-perform the operation of the control procedure.

Other Procedures

Detailed Comparison

An increase in consumption pattern with no corresponding increase in revenue could indicate that a problem exist in collectability of cost information related to consumption data. An increase in the number of employees in a service organization would lead the cost auditor to expect an increase in employee cost and corresponding increases in professional fees charged or revenue generated from rendering services.

Comparative Data

Such data on the various types of products sold or types of customers relative cost could help explaining period to period cost information / revenue and related fluctuations underlying such as uniform costing data.

Ratio Analysis

Ratio analysis support for the current cost statements or raise points for discussion. Certain institutions/industry associations produce statistics on an industry wide basis. Such statistics can be useful when compared to those of an entity's operations, and inquiries are made when difference from the industry trends occurs.

Graphs

Finally, consider the use of graphs to portray the results of procedures; Graphs visually highlight significant differences from period to period.

Techniques

There are a number of possible techniques that can be used to perform audit procedures. The objectives are to select the most appropriate technique to provide the intended levels of assurance and precision, such techniques includes:

- Ratio Analysis
- Trend Analysis
- Break- even Analysis
- Pattern Analysis; and
- Regression Analysis

Preparing Audit Checklists

A process-oriented checklist is the most suitable for audit of the cost statement. It draws the cost auditor's attention to the key facets of the process/activity under examination, and allows the detail to reside in the documented procedure or work instruction. The process-oriented checklist emphasis is on outcomes, and they can do this all on one page.

The benefits of checklists in an audit of cost statements are:

- Encourage a structured approach to the audit of cost statements,
- Ensure that important issues are covered,
- Ensure nothing important is overlooked,
- Assist in time management throughout the audit of cost statements,
- Convenient place to record any pre-cost audit concerns,
- Convenient place to record audit evidence and observations, and
- Record of what cost auditor examined and what was found.

An illustrative Audit Plan and Audit Procedures are explained in Appendix – III

CHAPTER – 7 DOCUMENTATION

Audit Documentation (whether maintained on paper or electronically) plays a critical role in:

- Assisting the engagement team in planning and performing the audit of cost statements;
- Providing evidence to demonstrate that the planned audit procedures were actually performed;
- Assisting engagement reviewers in carrying out their responsibilities in accordance with professional standards;
- Recording the judgement involved in forming the audit opinion;
- Recording matters of continuing significance for future audits of cost statements of entity.

Good audit documentation is appropriately organized, and provides a record of work done, the audit evidence obtained, the significant professional judgement applied, and the conclusions reached.

5.8 The Cost Auditor shall document the Overall audit strategy, the audit plan any significant changes made therein during the audit engagements and the reasons for the changes.

The cost auditor should document the following aspects while planning the audit of cost statements:

- The Overall Audit Strategy
- The Audit Plan
- Significant changes made during the audit
- Reasons for such changes

The cost auditor may summarize the overall audit strategy in the form of audit strategy memorandum and memo that contain key audit finding and decisions made regarding the overall scope, timing and conduct of the audit of cost statements. The cost auditor should share the audit strategy memorandum with the audit team members and share the overall strategy memo with management or those charged with governance.

An illustrative format of audit strategy memorandum and overall strategy memo has been included in Appendix – II to this practical guide.

The Audit Plan

The documentation of the audit plan is a record of the:

- Planned nature, timing and extent of risk assessment procedures
- Further audit procedures at the assertion level in response to the assessed risk

An illustrative format of documenting risk assessment procedures and planned audit procedures has been included in Appendix - to this Practical Guide.

The Audit Plan also serves as a record of the proper planning of audit procedures that can be reviewed and approved prior to their execution. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

An illustrative format of audit planning schedule has been included in Appendix - to this Practical Guide.

A record of the significant changes to the overall audit strategy and the audit plan and the reasons for such changes, and resulting changes to the planned nature, timing, and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit of cost statements. It also reflects the appropriate response to the significant changes occurring during the course of audit of cost statements.

Appendix –I

List of the Cost Auditing Standards / Standards on Cost Auditing

The following are the Standards of Cost Auditing issued by the Institute of Cost Accountants of India till March, 2017. These are classified in two categories

1. **Mandatory** (Approved by the Central Government)
2. **Recommendatory** (Approved by the Council of Institute of Cost Accountants of India – in process of approval by the Central Government)

Mandatory

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

Recommendatory

SCA- 105	*Agreeing the Terms of Cost Audit Engagements*
SCA- 106	*Audit Sampling*
SCA- 107	*Audit Evidence*
SCA- 108	*Materiality in Planning and Performing a 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 Auditor*
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*

SCA- 117 *Identifying and Assessing the Risks of Material Misstatements*

SCA- 118 *The Cost Auditor's Responses to Assessed Risks*

SCA- 119 *Related Parties*

Appendix–II

Illustrative Audit Strategy Memorandum and Memo

Development of the overall audit strategy begins at the commencement of the engagement, and is completed and then updated based on the information obtained from:

- Previous experience with the entity
- Preliminary (client acceptance and continuation) activities
- Knowledge from previous audits and other engagements with the entity
- Knowledge of business
- Discussions with the entity on changes since last period and recent operating results
- Audit team discussions and meetings
- Other external sources such as newspaper and Internet articles
- New information obtained, failed audit procedures, or new circumstances encountered during the audit that will change previously planned strategies
- Nature and scope of the audit
- Statutory deadlines and reporting format
- Relevant factors determining the direction of the audit efforts
- Nature, timing and extent of resources required for the audit

The time required to prepare an overall audit strategy will vary based on:

- Size and complexity of the entity
- Composition and size of the audit team
- Circumstances encountered in performing the audit

Developing the Overall Audit Strategy

The overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team. The strategy will document the decisions arising from conducting the planning steps outlined in the exhibit below. Specific details of risk assessment and further audit procedures to be performed would be documented in the detailed audit plan.

Basic Steps	Description
Getting Started	• Perform preliminary activities (client acceptance/ continuance and establish the terms of cost audit engagement). • Gather relevant information about the entity such as current operating results, results from previous cost audit engagements, and significant changes in the current period. • Assign staff to the engagement, including, where applicable, the engagement quality control reviewer and any experts required. • Schedule the audit team meeting (including the engagement partner) to discuss the susceptibility of material misstatements (due to error or fraud) in the cost statements. • Determine the appropriate timeframes (dates) when each aspect of audit work will be undertaken (inventory valuation, risk assessment procedures, external confirmations, the period-end visit, and meetings to discuss cost audit results).
Assessing Risks and Responses	• Determine materiality for the cost statements as a whole, and performance materiality. • Determine the nature and extent of the required risk assessment procedures and who will perform them. • When risk has been assessed at the cost statement level, develop an appropriate overall response. Also include the impact on the further audit procedures to be performed. • Communicate an overview of the planned scope and timing of the audit to those charged with governance. • Update and change the overall strategy and audit plan as necessary in light of new circumstances.
Engagement Characteristics	The cost reporting framework to be used. • Additional reports required, such as stand-alone operational and industry-specific requirements (by regulators, etc.).

Basic Steps	Description
	• Any need for specialized knowledge or expertise to address complex, specific, and high-risk audit areas. • Evidence required from service organizations. • Use of evidence obtained in previous cost audits (such as risk assessment procedures and tests of controls). • Effect of information technology on audit procedures (availability of data and use of computer-assisted audit techniques). • Need to introduce some unpredictability in performing cost audit procedures. • Availability of entity personnel and data.
Reporting Objectives	• Entity's timetable for reporting. • Timing of meetings with management and those charged with governance to discuss: ○ The nature, timing, and extent of the cost audit work. This could include basis for inventory valuation, external confirmations, and interim and other required procedures, ○ Status of audit work throughout the engagement, and ○ The cost auditor's report and other communications such as management letters. • Timing of meetings/communications among engagement team members to discuss: ○ Entity risk factors (business and fraud risk), ○ Nature, timing, and extent of work to be performed, ○ Review of work performed, and ○ Other communications with third parties.
Significant Factors	• Materiality (overall, individual cost statement areas, and

Basic Steps	Description

	performance materiality).
	• Preliminary assessment of risk at the overall cost statement level and the impact on the audit.
	• Preliminary identification of:
	  ○ Significant and material items of cost, cost heads, and disclosures; and
	  ○ Areas where there may be a higher risk of material misstatement.
	• How engagement team members will be reminded to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence.
	• Relevant results of previous cost audits, including identified control deficiencies and action taken by management to address them.
	• Discussions with firm's personnel who provided other services to the entity.
	• Evidence of management's attitude toward internal control, and importance attached to internal control generally throughout the entity.
	• Volume of transactions, which may determine whether it is more efficient for the cost auditor to rely on internal control.

Significant Changes and Developments	• Significant business developments affecting the entity, including changes in information technology and business processes, changes in key management and , mergers, and diversification. • Significant industry developments, such as changes in industry regulations and new reporting requirements. • Significant changes in the cost reporting framework, such as changes in cost accounting policies. • Other significant relevant developments, such as changes in

Basic Steps	Description
	the legal environment affecting the entity. i.e product wise or product group wise.
Nature, Timing, and Extent of Resources Required	• The engagement team (including, where necessary, the engagement quality control reviewer). • Assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement. • Engagement budgeting, including considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement.

When the risks of material misstatement have been identified and assessed, the overall strategy (including timing, staffing, and supervision) can be finalized, and the detailed audit plan developed. The detailed plan will set out the further audit procedures required at the assertion level that responds to the identified and assessed risks.

As work commences, changes may be required to the overall strategy and detailed plans to respond to new circumstances, audit findings, and other information obtained. Any such changes are to be documented along with the reasons in the audit documentation, such as the overall audit strategy or audit plan.

Illustrative Format of an Audit Strategy Memo

Objectives

The purpose of this document is to share with the Audit Committee / Board of Directors of proposed audit strategy in relation to the audit of BCD Limited (the Company) of the cost statements for the year ending 31st March 20.., comprising of the quantities details of items of cost as on that date, and the Cost Sheet showing element wise as well as per unit of cost of production , Reconciliation Statement of profits & indirect taxes and Statement of value addition and distribution of earnings for the year then ended and a summary of significant accounting policies and other explanatory information.

Management Responsibility for the Cost Statements

Management is responsible for preparation and fair presentation of these cost statements in accordance with *Standards of Cost Auditing* and *Cost Accounting Standards* issued by *Institute of Cost Accountants of India*, and for such internal control as management determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to error or fraud.

Our Responsibilities

Our responsibility in relation to the audit of cost statements is to provide an expression of an opinion on whether the cost statements are prepared, in all material respects, in accordance with *Generally Accepted Cost Accounting Principles* and *Cost Accounting Standards* (applicable cost reporting framework). Our cost audit is carried out in accordance with the Standards on Cost Auditing issued by the Institute of Cost Accountants of India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the cost statements are free from material misstatement and are adequate determination of cost of production / operation(s).

Our Overall Approach

An audit of cost statements involves performing audit procedures to obtain audit evidence about the cost heads, items of cost and disclosures in the cost statements. The audit procedures for this purpose depend on our judgement, including the assessment of the risks of material misstatement of the cost statements, whether due to fraud or error. An audit of cost statements also includes evaluating the appropriateness of cost accounting policies used and the reasonableness of the cost estimates made by management as well as evaluating the overall presentation of the cost statements. Our approach to the audit of cost statements is risk focused based on our understanding of the Company and its environment, including the company's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement at the cost statement level and assertion levels . We have planned to carry out audit procedures through obtaining sufficient appropriate audit evidence in relation to the assessed risks of material misstatement. As mentioned, we shall consider internal control relevant to the company's preparation and fair presentation of the cost statements however such consideration is not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. We shall communicate to you at the end of the audit of cost statement or if required during the audit about any deficiencies in internal control framework that we notice in course of our audit of cost statements however such communication shall not include all possible weaknesses in internal control that a more extensive review exercise might identify.

Discussion with Management

We have met with all the functional heads of the Company during our initial meetings at the commencement of the cost audit engagement and discussed salient features of our planning process with xxx (CFO/ CMA / Plant Head / Finance Head as appropriate). We have not yet verified the information obtained in such meetings while presenting through this document.

While developing the audit strategy, we have taken cognizance of the production / capacity / process flow / complexity of operations of the Company, its business strategies and risks and customized the audit strategy in accordance with such needs.

In course of the audit of cost statements and throughout the year, we shall closely interact with management of the Company to ensure timely responses to any emerging issues.

Use of experts / Third Party Premises

We shall use following experts on the cost audit engagement to gain sufficient appropriate evidence in relation to the respective area;

Third Party Premises

We shall visit the third party premises to study the job work done and wastages incurred of free supply of material to map abnormal and normal wastages, since the bench mark is not produced before us and the wastages are highly violate in nature.

Operations Experts

We shall use our cost auditor's expert to map the process flow / cost flow incurred and capacity determined as no previous reference is remain no longer valid due to up gradation of products and facilities.

IT Engineers

We shall use a team of IT experts to review the cost control chart / routing / internal control of the new ERP implemented during the year.

Materiality

We have determined our materiality levels as a part of our planning process and shall apply these levels throughout the audit to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the cost statement level as a whole.

Key Risks

Pursuant to the Standards on Auditing, following risks are required to be considered in all audits of cost statements:

1) Management override of controls – Generally, management remains in a position to manipulate accounting records and prepare fraudulent financial statements. Accordingly, the risk of management override of control is considered a key risk and we shall carry out controls testing and substantive procedures, including review of journal entries, accounting estimates and significant transactions that are outside the normal course of business.

2) Cost of Production / Cost of Operations - Due to the nature of business and regulatory framework in which the Company operates, we have considered this to be a key risk and we plan to perform any specific audit procedures for cost of production / cost of operation, such as performing detailed analytical procedures, extensive tests of details and visiting multiple branches of the Company.

As part of our planning we have identified the following additional key risk based on our initial discussions with management:

- New ERP Systems: - on account of the new ERP system implemented this year, we shall understand the controls embedded in the systems, re-perform and review reconciliations and also involve an IT expert team in this process.

We shall focus our attention on the aforesaid area of concern in the view of the potential elevated risks. The nature, extent and timing of audit procedures shall be appropriately adjusted depending on the risk of material misstatement assessed.

However, in course of audit, of we come across circumstances which may result in a potential risk of material misstatements, we shall change our audit procedures accordingly.

Fraud Risk Consideration

The primary responsibility for the prevention and detection of fraud rests with the Board of Directors of the company and its management. However, during the course of audit if any existence of fraud found, then it shall be reported according to requirements of Sec-143 (12) of the companies act, 2013.

We are required to consider fraud risk factors and respond to such factors in course of the audit of cost statements. While we believe the fraud risk to be low, we shall monitor the aspect of management override of control on an ongoing basis in course of our audit and update our audit approach if deemed necessary.

Independence

In accordance with the Standards on Cost Auditing, we are required to comply with ethical requirements and communicate to you all relationships between us and the Company that may have bearing on our independence. In our opinion and based on the safeguards we have put in place, we do not envisage any threats to objectivity and independence as on date.

Cost Audit Timelines

The proposed timelines as discussed with management are as follows:

Cost Audit Activity	**Timelines**
Developing audit strategy/ plan and meeting management	xxxx
Commencement of fieldwork	xxxx
Review by Engagement Partner/ Review Partner	xxxx
Issue draft cost audit report	xxxx
Clarification on cost auditor's qualification , if any	xxxx
Audit Committee/ Board of Directors to approve cost statements, discuss and sign cost auditor's report	xxxx

Audit Team

We have selected the audit team with requisite expertise and relevant experience as follows;

Designation	Name
Engagement Partner	Xxxx
Signing Partner / Review Partner	Xxxx
Senior Manager	Xxxx
Manager	Xxxx
Assistant Manager	Xxxx
Articles and other support staff	Xxxx

Audit Fees

Our proposed fee for this audit engagement is INR xxx exclusive of applicable taxes and out-of-pocket expenses (to be charged at actual).

Terms and conditions of the Engagement

We have agreed the detailed terms of the cost audit engagement with the management through our engagement letter dated XXX.

Appendix –III

Illustrative Audit Plan

Name of Cost Auditor / Engagement Partner	
Particulars of Client M/ S ----------------------- ------------------------------- --------------------------------	
Reference No.	Date
Prepared by	
Approved by	

1. *Define Scope*

   (a)....................................

   (b)....................................

2. *Purpose of Audit (Regulatory/ Voluntary/Mandatory)*

   (a)....................................

   (b)....................................

3. *Schedule of the Audit –*

   (Provided under Appendix IV)

   (a)....................................

   (b)....................................

4. *Timing of Communication*

   (a)....................................

   (b)....................................

5. *Engagement Terms*

(a)....................................

(b)....................................

6. Management Personal

(a)....................................

(b)....................................

7. Team Planning/ Allocation of Work

(Illustrated below)

(a)....................................

(b)....................................

8. Result of Inquiries

(a)....................................

(b)....................................

9. Result of Analytical Procedures

(a)....................................

(b)....................................

10. Observations and Inspection

(a)....................................

(b)....................................

11. Information gathered in previous audit for reliance to current period

(a)....................................

(b)....................................

12. SWOT Analysis

I. Strength

(a)....................................

(b)....................................

(c)....................................

II. Weakness

(a)....................................

(b)....................................

(c)....................................

III. Opportunities

(a)....................................

(b)....................................

(c)....................................

IV. Threats

(a)....................................

(b)....................................

(c)....................................

13. PEST Analysis

I. **Political**

(a) Regulatory bodies & process.................................

(b) Government policies..

(c) Funding, grants, subsidies.................................

II. Economic

(a) Domestic / Overseas situation...

(b) Tax Planning specific to products & services...............................

(c) Customer/ end user driver.................................

III. Social

(a) Environmental Effects.................................

(b) Cultural Issues.................................

(c) Demographic / Market / Segment Challenges ....

IV. Technological

(a) Research & Development...............................

(b) Technological Obsolesces ....

(c) ERP Systems...............................

14. Materiality Level

(a)...................................

(b)...................................

15. Evaluation of controls

(a)...................................

(b)...................................

16. Audit Procedures

(a)...................................

(b)...................................

17. Audit Evidence / Audit Findings

(a)...................................

(b)...................................

18. Written Representation

(a)...................................

(b)...................................

19. Audit Documentation

(a)...................................

(b)...................................

20. Conclusion

(a)...................................

(b)....................................

Engagement Partner *Signing Partner*

Date *Date*

Team Planning for Audit of Cost Statements

Name of Cost Auditor / Engagement Partner	
Particulars of Client M/ S ----------------------- ------------------------------- --------------------------------	
Reference No.	Date
Prepared by	
Approved by	

Description	**Hours**				
	Partner / Reviewer	Senior Team Member		Junior Team Member	
		B	A	B	A
Testing of Audit Sampling / Controls					
BOM Cost					
Direct Material Cost					
Direct Labour Cost					
Power and Fuel					
Production Overhead					

Royalty					
Interest and Finance Cost					
Indirect Expenses					
Administrative Overhead					
Selling & Distribution Overhead					
Employee Cost					
Other Area					
Substantive Audit Procedures					
Inventory Valuation (WIP/ FG / RM)					
Classification of Cost					
Allocation / Absorption of Cost					
Depreciation					
Captive Consumption					
Free Supplies of Materials					
Distribution of Overheads					
Capacity Utilization					
Conversion Cost					
Revenue / Other Income					

Engagement Partner *Signing Partner*

Date *Date*

Identification and Assessment of key Risk of Material Misstatements

(to be completed for all material cost heads, items of cost and disclosure)

Area	
Cost Head Balances / General Ledger Balance	
Components of the Cost Head / items of Cost / Sub G/L balances	
Understanding of the process based on inquiry with: - Management Those charged with governance - Internal Auditor / Other Auditor(s) - Business Process Owners / Plant Manager/ Process Supervisor - Any other source	
Results of preliminary audit procedures – any unusual or unexpected changes occurred or interrelationship	
Results of verifications of internal controls - Control Environment / Control activities - Monitoring of controls - Risk Assessment - Information system and business process	
Results of observation and inspection of : - Entity's operations - Documents, records and reports	

<table>
<tr><td>- Premises for forming opinion</td><td colspan="3"></td></tr>
<tr><td>Other information available
- Previous cost audits / experience
- Other engagements with similar industry / entity.
- Ongoing assessments
- Interim review / limited review for period.
- Discussion and supervision within team
- Any other source</td><td colspan="3"></td></tr>
<tr><td>Identified risks</td><td>Risk description</td><td>Inherent / Detection / Control</td><td>Assertion</td></tr>
<tr><td rowspan="3">Key risks</td><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td rowspan="3">Non- key risks</td><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td></tr>
<tr><td>Impact on any other area</td><td colspan="3"></td></tr>
</table>

Illustrative Audit Planned Procedure

(to be completed for all material cost heads, items of cost and disclosure)

Audit Program **Cost of Goods Sold**		*WP Ref:*	
		Prepared by:	
		Date:	
		Reviewed by:	
		Date:	
Client:			
Period:			
Subject:	Cost of Goods Sold		

Item Ledger / Account Balance :		***Amount in Rs.***
Cost Heads / Classes of Transactions :		

S.No.	Audit Procedures	Audit Assertion Addressed	Done By	W.P. Ref.
Test of Controls				
1.	Select a sample of transactions from each of the cost heads and check the following: *(only illustrative in nature, may be extensive in application of audit of cost statements)* - Transactions booked on actual and real time basis - Items of cost are supported by proper documentation. - Treatment of indirect taxes done as per company, cost accounting policy - Rebates, discounts and other transactions are booked as per cost accounting principles - Basis of measurement are uniform throughout the period. - Posting are made in correct cost ledger / cost heads / cost records			
Analytical Procedures				
1.	Perform analytical review of cost of sales and inquire and collaborate significant variations from prior period and budgeted amounts.			
2.	Compare gross profit margins with			

	comparable margins for the previous period with comparable margins for industry and with the budgeted margins for the current period and investigate unusual fluctuations.			
3.	Using benchmarks compare BOM cost, gross margins by product wise / product group wise, unit wise or period wise to those of the prior year and obtain explanation for unusual variances.			
4.	For other items in cost of goods sold: a) Review all item of cost analytically and document reasons for significant variance. b) Examine supporting documents for selected items to ensure their validity.			
Test of Details				
1.	Perform a predictive test of cost of goods sold by product wise, product group wise , unit wise by reference to details of units and its average cost. Investigate significant variances between the predicted and recorded period.			
1.	Expand the test of details to voucher test of transactions related to cost of goods sold by tracing unit costs to rely on consumption recorded in cost records.			
2.	Determine cost information asserted in cost reporting framework are true and fair in all material and quantifiable respect.			
3.	Perform tests for basis of allocation of overhead cost to product. 1. for fixed overheads - In case of under utilization of normal capacity, the unabsorbed overheads should be charged as an abnormal loss. - In case of abnormally high production, the allocated overheads should not exceed the actual amount as this may result in over valuation of inventory. 2. for variable overheads - expand test of details to verify the allocation made on actual production basis and consistent.			

	- Check the cost accounting policy for allocation of joint cost.			
4.	Perform test to verify transactions recorded relating to production overheads.			
5.	Perform test to verify cost estimate and provision made at the end of period.			
6.	Expand test of details to verify operating ration asserted , standard input – output norms and basis of absorption of normal and abnormal losses.			
7.	Perform test to verify the amount of depreciation recorded and any material difference in useful life of period, Further perform test of details to exclude treatment of Revaluation and impairment losses.			
8.	Perform predictive test based on the agreed / average prices and received quantity.			
9.	Determine that all disclosures have been in accordance with the requirements of cost accounting standards and relevant requirements under companies act, 2013 or requirement under any other act.			
10.	Conclude the result of work			

Appendix-IV

Illustrative format of Audit Planning Schedule

COST AUDIT PLAN: (INITIAL AUDIT)

Name of the Company:

Product(s) with CETA Headings:

Year under Audit:

Date of appointment:

Filing of CRA-2: Date of filing: SRN:

Work	Whom	Time / (days)	From... To	Remarks
First meeting with the MD/ CEO	Proprietor/ Partner in-charge	Half a day	On:	To explain the cost audit procedures and plans. To discuss and get the approval for the overall audit plan
Meeting the operating Staff	Proprietor/ Partner in-charge along with the audit manager	1 day	July 15 to July 31	Depending upon the time availability of Staff.
Plant / Unit visits	Audit Manager with the Audit assistants	1 - 2 days	August 1 to September 15	Depending upon the time availability of people.
Discussion on the company's systems and procedures 1	Proprietor/ Partner in charge with the audit team	1 day	September 15 to October 15	Internal review and this would form the basis of the depth of audit required and also the audit risk assessment procedures to be followed.
Discussion on the company's systems and procedures 2	Proprietor/ Partner in charge with the audit team	1day	October 31 to December 15	Detailed discussions with Cost Centre wise audit observations. To plan the further work and also to ensure the initial findings corroborate with the interim opinions formed.
Meetings with the unit / cost	Proprietor / Partner in-charge along with the team	1 day	December 16 to February 15	Explain the cost audit team's views and confirm that the cost statements /

centre heads				reports generated are up to the expectations to perform the audit.
Meeting with the MD / CEO	Proprietor / Partner in-charge	Half a day	February 20 to March 15	Depending upon the availability of the time of MD/ CEO to present the initial findings and also get their views and issues.
Meeting with the MD/CEO	Proprietor / Partner in-charge along with the audit manager	One hour	April 10 to May 10	Depending upon the availability of the time of MD/ CEO to understand the completion of the financial statements for the year and also the statutory audit plan. If the audit is completed, then to officially receive the financial statements along with the cost statements for the year.
Completion of Audit Meeting – 1	Audit Manager along with the team	1 - 2 days	From the date of the receipt of the cost statements	Audit progress report along with the cost statements that are checked, verified and audited with the notes and the audit findings and other details.
Completion of Audit Meeting -2	Proprietor / Partner in charge with the Audit Manager	1 day	From the date of receipt of the draft report from the team	To discuss and the proprietor / partner in charge should make the best of his judgement about the audit queries and direct the audit manager to work further wherever more detailed studies are required.
Completion of Audit 3	Proprietor / Partner in charge to meet and discuss the Key Managerial Personnel / Director	1 day	Depending upon the availability of the KMP / Director	The audit queries have to get clarified and the areas which are to be qualified should be highlighted to the KMP / Director and if they need reasonable time to explain to be offered.
Completion of Audit 4	Proprietor / Partner in charge with the audit team	1 day	From the date of completion of detailed work assigned after	Based on the details and the explanations received from the KMP / Director the audit report should be

			audit 2 and also the clarifications received from the KMP / Director for the queries raised.	completed in all aspects and released to the company along with the bill for the services as per the appointment letter.

COST AUDIT PLAN: (SUBSEQUENT AUDIT)

- Name of the Company:
- Product(s) with CETA Headings:
- Year under Audit:
- Date of appointment:
- Filing of CRA-2: Date of filing: SRN:

Work	Whom	Time (days)	From... To	Remarks
Meetings with the unit / cost centre heads	Proprietor / Partner in-charge along with the team	One day	December 16 to February 15	Explain the cost audit teams views and confirm that the cost statements / reports generated are up to the expectations to perform the audit.
Meeting with the MD / CEO	Proprietor / Partner in-charge	Half a day	February 20 to March 15	Depending upon the availability of the time of MD/ CEO to present the initial findings and also get their views and issues.
Meeting with the MD/CEO	Proprietor / Partner in-charge along with the audit manager	One hour	April 10 to May 10	Depending upon the availability of the time of MD/ CEO to understand the completion of the financial statements for the year and also the statutory audit plan. If the audit is completed, then to officially receive the financial statements along with the cost statements for the year.
Completion of Audit Meeting - 1	Audit Manager along with the team	2 days	From the date of the receipt of the cost statements	Audit Progress report along with the cost statements that are checked, verified and audited with the notes and the audit findings and other details.
Completion	Proprietor /	5	From the date of	They have to discuss and the

of Audit Meeting – 2	Partner in charge with the Audit Manager		receipt of the draft report from the team	proprietor / partner in charge should make the best of his judgement about the audit queries and direct the audit manager to work further wherever more detailed studies are required.
Completion of Audit Meeting – 3	Proprietor / Partner in charge to meet and discuss the Key Managerial Personnel / Director	1 day	Depending upon the availability of the KMP / Director	The audit queries have to get clarified and the areas which are to be qualified should be highlighted to the KMP / Director and if they need reasonable time to explain to be offered.
Completion of Audit Meeting – 4	Proprietor / Partner in charge with the audit team	1 day	From the date of completion of detailed work assigned after audit 2 and also the clarifications received from the KMP / Director for the queries raised.	Based on the details and the explanations received from the KMP / Director the audit report should be completed in all aspects and released to the company along with the bill for the services as per the appointment letter.

Note: In case of change of Audit Team from Previous Year, additional meetings / plans with Clients team will be required.

Appendix – V

Prospective Client Acceptance/Existing Client's Continuation Memorandum

The cost auditor is generally more careful about accepting the new client because of lack of previous experience with the management and those charged with the governance and knowledge of the business, transactions and associated risks affecting the cost statements.

While certain assessment procedures for both the prospective and existing clients would be common, however, they may assume additional importance in case of a new client. The cost auditor also needs to communicate with the predecessor cost auditor.

This illustrative memorandum should be filled and signed before accepting all the new / initial cost audit engagements.

I. Prospective client identity and source (consider following questions)

- ✓ Whether the entity is one of the following
    - a) Listed / Non- Listed
    - b) Regulatory / Non- Regulatory
    - c) Multi- locational / Multi Products
    - d) Manufacturing / Service Industry / both
    - e) Other (Specify)
- ✓ What has been cost auditor's experience with the client or any other company of the same group?
- ✓ Has the work been referred for specific engagements?
- ✓ What are the significant risks associated with accepting new client?
- ✓ Consider that no conflict of interest arises in respect of service being provided as a result of accepting audit of cost statements in view law and regulations, code of ethics and other legal provisions?

II. Background information on the business / operations

- ✓ What is known about prospective business / operations client?
- ✓ What is the business goodwill / market share of the prospective client, its promoters / those charged with governance, and its management?
- ✓ How capable is / are the management / those charges with the governance in managing operations ?
- ✓ What is known about the integrity of the principal owners/those charged with the governance and management?
- ✓ Is there a dominant Chief Executive Officer / Chief Financial Officer / Chief Management Officer?
- ✓ Whether the cost auditor can meet with the Audit Committee/ Board of directors freely and without the Executives present?
- ✓ What is the operational status of the prospective client (particularly capacity determination / joint product – by product, multi products, discontinuing operations , multi product lines , power and other gas and fuel generations and viability)?
- ✓ Whether the management has a significant personal financial interest in the operational result?
- ✓ What is the integrity of those with significant influence over cost reporting (including fraudulent acts, non-bias in producing estimates, revenue/ earnings management)?
- ✓ What is known about the industry in which the prospective client operates and the risks it presents?
- ✓ What reasons are given for the change of cost auditor(s) and why we or our firm was selected?
- ✓ Whether the cost auditor / firm is competent and capable of handling the audit of cost statements of the prospective client?
- ✓ Whether there would be need of a cost auditor's expert?

- ✓ In case of lead audit engagements whether the engagement team is capable of acting as lead auditors? What are profile of other cost auditor(s)
- ✓ Is there any concern that the laed engagement team will not be able to gain sufficient appropriate audit evidence in relation to the consolidation process and the cost information of the components/ units on which to base the lead cost auditor(s) opinion?

III. Results of enquires with third party

- ✓ Enter the details of discussion with third parties (i.e. regulator, Job worker, supplier ?

IV. Cost auditor's association with prospective client (consider the following questions)

- ✓ Whether the preconditions for an audit of cost statements are present, that is, the use by management of an acceptable cost reporting framework in the preparation of the cost statements and the agreement of management or those charged with governance to the premise on which an audit of cost statements is conducted?
- ✓ Whether any limitation of scope is likely that would result in a disclaimer of cost auditor's opinion?
- ✓ What is the need to accept the cost audit even where the limitation on scope is or likely to be imposed by the management?

- ✓ Are there any relationships that may impair cost auditor's objectivity or ability to meet any relevant independence requirements?
- ✓ Are there any potential conflict of interest affecting auditor's ability to accept the engagement? For example providing cost audit and maintenances of cost records services to the same client. If there is a conflict of interest whether the

  interest conflicting with audit of cost statements removed or safeguards available that reduces the risk to an acceptable level?
- ✓ Have any relevant statutory or other regulatory provision been identified, including any implications on the auditor's ability to act for the client?

1. Conflicts of Interest

Enter details of issues that might lead to potential conflict of interest?

2. Expertise

Enter details of the skill and experience the cost auditor has makes it suitable for this client.

3. Fee Recovery

Enter details of the estimated fees, and review that an acceptable level of recovery of audit cost is expected.

4. Other Services

Comment on the potential for providing other services to the client and suggest actions for taking advantages of these, i.e. benchmarking, process mapping.

V. Initial assessment of risk associated with the prospective client

Specify the areas of concern that the client presents and explain how the risk will be managed.

VI. Results of enquires with predecessor cost auditor

Document the results of enquiries with predecessor cost auditor and comment on the same.

VII. Independence Factors

Consider all factors that could impair the cost auditor /firm's or network's independence for engagement including Statutory, Legal, Regulatory or Code of Ethics and other applicable independence rules. Determine if any of the following challenges are present:

1. Proposed or prospective services
2. Firm financial or business relationships with the client
3. Ex-cost auditor/ firm staff working for the client in a position of influence
4. Cost auditor / Firm professionals who were formerly employed by the client with involvement in the cost audit engagement
5. Audit team's and other covered persons' family members employed by the client
6. Long association of a senior team member with the client

VIII. Other Factors

Enter details of any other areas of concern or issues for consideration. For example

Whether the firm has previously decline to perform cost audit engagement for this client if so give reasons and state mitigating factors for acceptance?

IX. Conclusion

On the basis of the above, we conclude that there is no reason to believe that the overall level of risk associated with __________________________ is sufficient to prevent the client from being accepted and there are no other circumstances of which we are aware associated with __________ _________________that suggest that the client should not be accepted.

OR

The circumstances identified from the above assessment have been disposed of as follows:

1. _____________________

2. _____________________

Significant risks

Based on the assessment following significant risks are identified, which needs to be addressed while planning and performing the audit

1. _______________

2. ________________

OR

On the basis of above and due to-------------------------- the offer is declined.

Signed. _______________ . _______________

Proposed Engagement partner / Cost Auditor Senior partner

. _______________ . _______________

Date Date

II. Existing Client Continuation/ Retention Memorandum

S No.	Description	Yes	No
1	Is there a significant change in the nature, size or structure of the client's business / operations? If yes state increased risk associated with the change and why the cost auditor /firm should still continue with such client.		
2	Is there a request by another partner for re-evaluation of the engagement? If yes, state reasons for such request.		
3	Is there any new legal, regulatory or professional requirements that alter the planning, performance and reporting responsibilities?		
4	Are there any concerns about a team member’s ability to meet the applicable requirements?		
5	Is there any new legal, regulatory or professional requirements that alter the planning, performance and reporting responsibilities?		

6	Is there a significant change in management or those charged with the governance?		
7	Is there any reason whether due to past experience or present development to question or be concerned about the reputation, character, or integrity of management and/or those charged with the governance?		
8	Is there any known problem of independence by reason of activities or relationships of partner or professional staff in relation to the client?		
9	Is the client involved in any significant current or possible litigation?		
10	Did the client re-evaluation indicate a change in operation performance of the client?		
11	Whether there would be need of an cost auditor's expert?		
12	Are there any concerns over the resources available within the cost auditor / firm to meet any identified need for experts?		
13	In case of lead audit engagement whether the engagement team is capable of acting as lead auditors?		
14	Is there any concern that the lead engagement team will not be able to gain sufficient appropriate audit evidence in relation to the consolidation process and the cost information of the components/ units on which to base the lead audit opinion?		

Independence Factors

Consider all factors that could impair the cost auditor /firm's or network's independence for engagement including Statutory, Legal, Regulatory or Code of Ethics and other applicable independence rules. Determine if any of the following challenges are present:

1. Other services provided to the entity and its related entities in the previous 2 years
2. Proposed or prospective services

3. Firm financial or business relationships with the client
4. Ex-cost auditor/ firm staff working for the client in a position of influence
5. Cost auditor / Firm professionals who were formerly employed by the client with involvement in the cost audit engagement
6. Audit team's and other covered persons' family members employed by the client
7. Long association of a senior team member with the client
8. Threat of replacement over a disagreement with cost accounting policy (s)/ cost reporting framework

Changes to Audit Risks and Other Matters

Consider matters (including any identified in the Client Acceptance) including whether there are issues in relation to:

1. Going concern, financial viability, operational viability, continued existence
2. Related parties
3. Current or possible litigation against the client
4. Compliance with laws and regulation including any regulatory investigations
5. Suspected or identified frauds
6. Items noted in Financial Statement review, if any
7. Internal audit reports / Internal Controls
8. Other matters

Conclusion

On the basis of the above it is concluded that the firm should / should not continue our client engagement.

If decided to continue:

The circumstances identified (if any) from the above assessment have been disposed of as follows:

1. ______________________________

2. ______________________________

Significant risks

Based on the assessment following significant risks (if any) are identified which needs to be addressed while planning and performing the audit of cost statements:

1. --

2. --

3. --

Signed _______________	. _______________
Proposed Engagement partner / Cost Auditor	Senior partner
. _______________	. _______________
Date	Date

Appendix – VI

Example of Cost Audit Engagement Letter

The following is an example of a cost audit engagement letter for an audit of general purpose cost statements prepared in accordance with Cost Accounting Standards (CAS). This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this Standard. It will need to be varied according to individual requirements and circumstances. It is drafted to refer to the audit of cost statements for a single reporting period and would require adaptation if intended or expected to apply to recurring cost audits (see paragraph 5.8 of SCA-105). It may be appropriate to seek legal advice that any proposed letter is suitable.

***

The Board of Directors[1]
[or those charged with governance]
ABC Company

[***The objective and scope of the cost audit***]

You[2] have requested that we audit the cost statements of ABC Company, which comprise the following:[3]

1. quantitative details of capacity, production and sales;
2. cost sheet showing element-wise per unit cost of production of goods or provision of services, cost of sales and margin for each product or service;
3. reconciliation of profits, as per cost accounts and as per financial accounts;
4. statement of value addition and distribution of earnings; and
5. any explanatory note annexed to, or forming part of, any document referred to in (i) to (iv) above.

We are pleased to confirm our acceptance and our understanding of this cost audit engagement by means of this letter. Our cost audit will be conducted with the objective of our expressing an opinion on the cost statements, cost records and other related cost information.

[***The responsibilities of the cost auditor***]

We will conduct our cost audit in accordance with standards on cost auditing issued by the Institute of Cost Accountants of India. Those standards require that we comply with ethical requirements and plan and perform the cost audit to obtain reasonable assurance about whether the cost statements are free from material misstatement. An audit involves performing procedures to obtain the audit evidence about the amounts and disclosures in the cost statements. The procedures selected depend on the cost auditor's judgment, including the assessment of the risks of material misstatement of the cost statements, whether due to fraud or error. Cost audit also includes evaluating the appropriateness of cost accounting policies used and the reasonableness of cost accounting estimates made by management, as well as evaluating the overall presentation of the cost statements.[4]

---

[1] The addresses and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction.

[2] Throughout this letter, references to "you", "we", "us", "management", "those charged with governance", and "cost auditor" would be used or amended as appropriate in the circumstances.

[3] Details comprising cost statements may be amended as required under the applicable cost reporting framework, or as prescribed by law or regulation.

[4] Where the cost statements of the entity include cost statements/information of its other units which has been audited by another cost auditor/cost auditors, the engagement letter may be modified accordingly.

Because of the inherent limitations of cost audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the cost audit is properly planned and performed in accordance with standards on cost auditing.

In making our risk assessments, we consider internal control relevant to the entity's preparation of the cost statements in order to design cost audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the cost statements that we have identified during the cost audit.

[***The responsibilities of management and identification of the applicable cost reporting framework*** *(for purposes of this example it is assumed that the cost auditor has not* *determined that the law or regulation prescribes those responsibilities in appropriate terms; the descriptions in paragraph 5.1(b) of SCA-105 are therefore used)*]

Our cost audit will be conducted on the basis that management and where appropriate, those charged with governance, acknowledge and understand that they have responsibility:

(a) For preparation and presentation of cost statements in accordance with applicable cost reporting framework that gives true and fair per unit cost of production or cost of operations, cost of sales, and margin for each product or service or activity, produced or provided your company for the period under audit;

(b) For selection and consistent application of appropriate cost accounting policies;

(c) For implementation of cost accounting standards issued by the Institute, alongwith proper explanation relating to any material departures from those cost accounting standards;

(d) For such internal control as the [management] determines is necessary to enable the preparation of cost statements that are free from material misstatement, whether due to fraud or error; and

(e) To provide us with:

a. Access, at all times, to all information, including the books, account, vouchers, cost records, other records, documentation, and other matters of the company, whether kept at the head office of the company or elsewhere, of which [management] is aware that is relevant to the preparation of the cost statements;

b. Additional information that we may request from [management] for the purpose of the cost audit; and

c. Unrestricted access to persons within the entity from whom we determine it necessary to obtain cost audit evidence. This includes our entitlement to require from the officers of the company such information and explanations as we may think necessary for the performance of our duties as cost auditor.

As part of our cost audit process, we will request from [management and where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the cost audit.

We look forward to full cooperation from your staff during our cost audit.

[***Other relevant information***]

[*Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.*]

[***Reporting***]

[*Insert appropriate reference to the expected form and content of the cost auditor's report*]

The form and content of our report may need to be amended in the light of our cost audit findings.

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

....

XYZ & Co.
Cost Auditors
(Proprietor/Partner)

Acknowledged and agreed on behalf of ABC Company by

(Signed)

....

Name and Title

Date

Appendix – VII

CAAS – 101
Cost Auditing Standard on
Planning an Audit of Cost Statements

The following is the **Cost Auditing Standard** (CAAS 101) on "**Planning an Audit of Cost Statements**". 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

Planning an audit of cost statements, records and other related documents is considered necessary to ensure achievement of audit objectives with available resources and securing coordination with the auditee on audit work.

2. Objective

The objective of this Standard is to guide the members in planning for the audit of cost statements so that it is performed in an efficient and effective manner. Audit planning shall also include establishing the overall audit strategy and audit plan for the conduct of the audit.

3. Scope

This Standard deals with the auditors' responsibility to plan an audit of cost statements, records and other related documents. The auditor shall prepare and document the overall audit strategy and audit plan.

4. Definitions

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

4.1 ***Audit: 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 ***Audit Partner: Audit partner means the partner 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 audit 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.***

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

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.***

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

(1) ***Inherent risk: the susceptibility of an assertion about the measurement, assignment or disclosure of cost to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.***

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

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

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

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

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

4.8 ***Cost Auditor: "Cost Auditor" means an auditor appointed to conduct an audit of cost records and shall be a cost accountant within the meaning of The Cost and Works Accountants Act 1959. "Cost 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.

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

4.10 ***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.***

4.11 ***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.***

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.

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

4.13 ***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.***

5. Requirements

5.1 Prior to entering the planning phase, the Cost Auditor shall ensure that:

(a) the appointment as cost auditor is proper, he has received the letter of appointment and legal formalities regarding his appointment have been complied with;

(b) ***the ethical requirements as per the regulations continue to be satisfied; (Refer 6.3)***

(c) ***an understanding of the terms of reference including the units to be covered, products/services to be covered, scope of coverage where the regulations leave it to be agreed between the auditor and the auditee.***

5.2 ***The audit partner and other key members of an audit team shall be involved in planning the audit, including planning and participating in the discussion among audit team members. (Refer 6.4)***

5.3 ***The Cost Auditor shall formulate an Overall audit strategy that sets the scope, timing and direction of the audit.***

The overall audit strategy guides the development of the audit plan.

5.4 ***In formulating the Overall audit strategy, the Cost Auditor shall consider all relevant factors. (Refer 6.5)***

These relevant factors include:

(a) results of preliminary activities as specified in 5.1 above

(b) knowledge from previous audits and other engagements with the auditee

(c) knowledge of business

(d) nature and scope of the audit

(e) statutory deadlines and reporting format

(f) relevant factors determining the direction of the audit efforts

(g) nature, timing and extent of resources required for the audit.

5.5 ***The Cost Auditor shall develop an audit plan.***

The audit plan will include the nature, extent and timing of risk assessment, audit procedures and other activities (Refer 6.5, 6.6)

5.6 ***The Cost Auditor shall plan the nature, extent and timing of the direction and supervision of audit team members and the review of their work.(Refer 6.7)***

5.7 ***The Cost Auditor shall update the Overall audit strategy and the audit plan as required during the course of audit. (Refer 6.8)***

5.8 The Cost Auditor shall document the overall audit strategy, the audit plan and any significant changes made therein during the audit engagements and the reasons for the changes.

5.9 In the initial audit, the Cost Auditor shall perform procedures regarding the acceptance of the client relationship and the specific audit.

In case where the audit of the entity for the prior period was conducted by a different audit firm, the auditor shall communicate with the previous auditor. (Refer 6.9)

6. Application Guidance

6.1 The nature and extent of planning activities will vary according to the:

(a) size and complexity of the entity's activities, the number of products to be covered, the processes and operations involved.

(b) the audit team members' previous experience with the entity and the industry.

(c) changes in circumstances that occur during the audit.

6.2 Planning is not a discrete phase of an audit, but rather a continuous and iterative process. Planning includes scheduling which involves determining the priority of audit procedures and their inter dependence. For example, the risk assessment procedures are planned early in the audit process.

6.3 Prior to the performance of other significant activities for the current year's audit, the auditor shall ensure that {Refer 5.1 (b)} :

(a) After the Cost Auditor has accepted the appointment for an entity, there are no changes in his position in relation to the entity that impede his arm's length relationship with the entity. Such as, acceptance of an assignment relating to designing and implementation of cost accounting system for the entity.

(b) Subsequent to his acceptance of the assignment, no issues about management integrity has cropped up that may affect the auditor's willingness to continue the engagement.

6.4 The involvement of the audit partner and other key members of the audit team in planning the audit draws on their experience and insights, thereby enhancing the effectiveness and efficiency of the planning process.(Refer 5.2)

6.5 Matters that are relevant in formulating the overall audit strategy and drawing up the audit plan include, in addition to those mentioned earlier, the following (Refer 5.4, 5.5):

(a) The cost reporting framework generally prescribed, under the Companies Act and Rules prescribed thereunder, as well as under any other law as applicable, on the basis of which the cost information to be audited has been prepared, including need for reconciliation with financial reporting framework.

(b) Industry regulators' requirement as to how costs will be handled.

(c) Unique features of an industry that influence audit requirements such as definition of product in the newspaper industry.

(d) Reliance that can be placed on the work of financial auditors, other cost auditors appointed by the entity and internal auditors. such as their attendance in annual stocktaking

(e) State of IT (Information Technology) implementation, whether the entity is using an ERP (Enterprise Resource Planning) system or internally developed systems and the reliance that can be placed on them.

(f) Statutory timelines for cost reporting, which can be modified by the management for early completion.

(g) Timelines for Board/ audit committee meetings, which can set the time limits for completion of audit work.

(h) Resources required and available in terms of manpower, equipment and others and the assignment of these to specific parts of the work.

6.6 The audit plan is more detailed than the overall audit strategy as it includes the nature, timing and extent of audit procedures to be performed by audit team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. (Refer 5.5)

6.7 The nature, extent and timing of the direction and supervision of audit team members and review of their work vary depending on, among others, the size and complexity of the entities activities, risk assessment results and the capabilities and competence of the individual team members performing the audit work.(Refer 5.6)

6.8 As a result of unexpected events, changes in conditions or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan. (Refer 5.7)

6.9 Additional Consideration in Initial Audit Engagements (Refer 5.9): The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For the initial audit, additional matters the auditor may consider in formulating the overall audit strategy and audit plan include the following.

(a) The planning activities may expand to cover consultations with the previous auditor, review of previous year's audit working papers, if not prohibited by other Law or regulation, and previous year's transactions having an impact on current year's cost.

(b) Any major issues (including the application of cost accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as cost auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.

(c) The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (such as Inventory).

(d) Other procedures required by the firm's system of quality control for initial cost audit engagements (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).

6.10 In audits of small entities where the entire audit may be conducted by a small audit team comprising the audit partner working with say one team member, formulating the audit strategy and drawing up the audit plan need not be elaborate. Nonetheless it is necessary to have regard to the matters mentioned under Requirements.

7. Effective Date

This standard is to be applied for the period commencing on or after____________.