

Cost Auditing and Assurance Standards

5

This Module includes:

5.1 Cost Auditing Standards - Overview

Cost Auditing and Assurance Standards

SLOB Mapped against the Module

To develop detail understanding of Cost Auditing Standards to ensure appropriate evaluation of cost records maintained. (CMLO 4a, b)

Module Learning Objectives:

This module discusses the Cost Auditing Standards. Cost Auditing Standards are designed to achieve uniformity and consistency in the cost auditing principles and to establish regulations and also to follow the disclosed practices consistently and to comply with promulgated Cost Auditing Standards. After studying this module, the students will be able to –

- ▲ Get an overview about the Cost Auditing and Assurance Standards

The Companies (Cost Records and Audit) Rules, 2014 [as amended from time to time] were notified by the Ministry of Corporate Affairs, Government of India in exercise of the powers conferred by section 148 of the Companies Act, 2013.

Sub-section (3) of section 148 prescribes that the auditor conducting the cost audit shall comply with the *cost auditing standards*. This proviso to be read with the following explanation:

Explanation—*For the purposes of this sub-section, the expression “cost auditing standards” mean such standards as are issued by the Institute of Cost Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.*

While formulating the Standards, the Cost Audit & Assurance Standards Board [CAASB] 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 of the Cost Accountants of India. The Standards issued by the CAASB are aligned, to the extent possible, with other recognised Standards issued in India and prevailing International Practices. If a particular standard or any part thereof is inconsistent with a law, the provisions of the said law shall prevail.

Standards formulated by the CAASB include paragraphs in ***bold italic type*** and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. Each Standard should be read in the context of the objective stated in that Standard and the Preface to CAASB which is available on the Institute website and also given in Volume-II of this Guide. Any limitation on the applicability of a Standard is made clear in the Standard itself.

Cost Auditing Standards – Overview

5.1

The Institute of Cost Accountants of India is a founder member of the International Federation of Accountants (IFAC). The International Auditing and Assurance Standards Board (IAASB) established under the authority of IFAC have issued series of International Standards on Auditing (ISAs). These Standards have been widely acknowledged and adopted [with or without any modifications] by all professional Institutes across the world. As a founder member of IFAC, the Institute could have also adopted these Standards. However, as these Standards are primarily focussed on the financial audit; hence there was need to modify their content to the extent required.

It is a well-known fact that prima facie, the function of “Audit” per se do not differ in any audit assignment except for its ‘scope’ and the ‘target clientele’. Broadly, the role & responsibility of an auditor, be it financial audit or cost audit, remains same. For all practical purposes and under provision of law, cost auditor has same rights, duties, and obligations as applicable to the financial auditor. Hence, even though the cost accounting differs from financial accounting, but the audit practice thereof does not differ. Therefore, Standards on Cost Auditing [SCAs] issued by the Institute are, in-principle, based on the International Standards on Auditing [ISAs] with suitable modifications in framework and content wherever found necessary.

Government of India, Ministry of Corporate Affairs, vide their letter no. 52/33/CAB/2013 dated 10th September, 2015 has, under section 148(3) of the Companies Act, 2013, granted Central Government’s approval to the following Cost Auditing Standards:

1. Cost Auditing Standard-101 on Planning an audit of Cost Statements;
2. Cost Auditing Standard-102 on Cost Audit Documentation;
3. Cost Auditing Standard-103 on Overall objectives of the independent cost auditor and the conduct of an Audit in accordance with Cost Auditing Standards;
4. Cost Auditing Standard-104 on Knowledge of business, its processes and the business environment.

COST AUDITING STANDARDS

Cost Auditing Standard on Planning an Audit of Cost Statements - 101

The following is the **Cost Auditing Standard (Cost Auditing Standard- 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 sub-section (1) of section 6 and who is deemed to be in practice under sub-section (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.
 - (a) the audit team members' previous experience with the entity and the industry.
 - (b) 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 effective for audits on or after September 11, 2015.

Cost Auditing Standard on Cost Audit Documentation – 102

The following is the **Cost Auditing Standard (Cost Auditing Standard-102)** on “**Cost Audit Documentation**”. 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

The purpose of this Standard is to provide guidance to the members in preparation of Audit Documentation in the context of the audit of cost statements, records and other related documents.

Nature and Purpose of Cost Audit Documentation

Cost Audit documentation that meets the requirement of this Cost Auditing Standard and the specific documentation requirements of other relevant Cost Auditing Standards provides:

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

Cost Audit documentation serves a number of additional purposes, including the following:

- (a) Assisting the audit team to plan and perform the cost audit.
- (b) Assisting members of the audit team responsible for supervision to direct and supervise the cost audit work, and to discharge their review responsibilities.
- (c) Enabling the audit team to be accountable for its work.
- (d) Retaining a record of matters of continuing significance to future cost audits.
- (e) Enabling the conduct of quality control reviews in accordance with the Guidance Manual for Audit Quality issued by Quality Review Board (QRB).
- (f) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

2. Objective

The objective of this Standard is to guide the members to prepare documentation that provides:

- (a) A sufficient and appropriate record of the basis for the Cost Auditor’s Report; and*
- (b) Evidence that the audit was planned and performed in accordance with Cost Auditing Standards and applicable legal & regulatory requirements.*

3. Scope

This Standard deals with the cost auditor’s responsibility to prepare audit documentation for the audit of cost statements, records and other related documents. The specific documentation requirements of other Cost Auditing Standard’s do not limit the application of this Cost Auditing Standard. Laws or regulations may establish additional documentation requirements.

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 documentation:** *Audit Documentation means the records, in physical or electronic form, including working papers prepared by and for, or obtained and retained by the Cost auditor, in connection with the performance of the audit.*
- 4.3 Audit file:** *Audit file means one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific Assignment or audit.*
- 4.4 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.*
- 4.5 Audit Team:** *Audit team means all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.*
- 4.6 Audit working papers:** *Audit working papers are the documents which record all audit evidence obtained during audit. Such documents are used to support the audit work done in order to provide assurance that the audit was performed in accordance with the relevant Cost Auditing Standards.*
- 4.7 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 sub-section (2) of section 2 of that Act and includes a firm of cost accountants.*
- 4.8 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.*

5. Requirements

- 5.1** *The cost auditor as part of the audit documentation shall record audit procedures performed, relevant audit evidence obtained, and conclusions reached. (Refer 6.1)*
- 5.2** *The Cost Auditor shall prepare audit documentation that is sufficient to enable another competent person, having no previous connection with the said audit, including person undertaking peer review to understand:*
- (a) Conformance of audit procedures performed with legal and regulatory requirements;*
 - (b) Conformance to Cost Auditing Standards. (Refer 6.6)*
 - (c) The results of audit procedures performed*
 - (d) The audit evidence obtained*
 - (e) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Refer 6.7 & 6.8)*

- 5.3 *The Cost Auditor shall record the discussions of significant matters with client personnel and outsiders. (Refer 6.9).*
- 5.4 *The Cost Auditor shall record any departure from the standard requirement in a Cost Auditing Standard. (Refer 6.11)*
- 5.5 *In documenting the nature, timing and extent of audit procedures performed, the Cost Auditor shall record the characteristics of the specific items or matters tested, the persons responsible for performing and reviewing such procedures with relevant dates and extent of review. (Refer 6.12)*
- 5.6 *The Cost Auditor shall prepare audit documentation on a timely basis. (Refer 6.14)*
- 5.7 *If, in exceptional circumstances, Cost Auditor performs any new or additional audit procedures or draws new conclusions, after the date of Cost Audit Report, then he shall document such circumstances and details of such procedures performed. (Refer 6.15)*
- 5.8 *The cost auditor shall assemble the audit documentation in an audit file. (Refer 6.16)*

6. Application Guidance

6.1. The Cost Audit documentation will usually contain:

(a) *Checklists*

Example: Checklist of compliance with:-(1) The Rules, regarding maintenance of Cost Records, as prescribed under the Companies Act,

(2) The Cost Accounting Standards (CAS) as prescribed by the Institute

(3) The Generally Accepted Cost Accounting Principles (GACAP) as prescribed by the Institute

(b) *Audit programs*

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

(c) *Analysis*

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

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

(d) *Audit Query List*

Contains a log of audit queries raised and their resolution

(e) *Abstracts of significant contracts relating to costs and revenues*

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

(f) *Letters of confirmation*

Example: Stock of materials with subcontractors.

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

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

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

- 6.2. Audit documentation may be in paper form or electronic form. Where it is in electronic form, special care may be required to protect against accidental deletion, or tampering.
- 6.3. The content and form of audit documentation will depend on a number of factors such as:
- (a) the size and complexity of the operations of the auditee,
 - (b) the extent of computerization of cost records,
 - (c) the assessed risks of material misstatement of cost,
 - (d) the cost audit methodology and tools used. For example whether automated queries were used to get audit evidence from cost records.
 - (e) the nature of the audit procedure to be performed.
- 6.4. In particular, it is necessary to document the basis for a conclusion, not readily determinable from other documentation. For example: consumption of materials by a product from technical norms, normal price for a related party contract from Cost Auditor's own sources of data of the industry.
- 6.5. Audit documentation must be sufficient and appropriate, and oral explanations by the Cost Auditor cannot substitute for such documentation.
- 6.6. Audit documentation must contain evidence of conformance to requirements of Cost Auditing Standards in respect of this Standard and other standards {Refer 5.2(b)}:
- Typical of such evidence are:
- (a) an adequately documented audit plan
 - (b) the signed appointment letter from the auditee
 - (c) Minutes of discussion with client personnel, with names of members of audit team present, particularly of the audit partner when he is present
 - (d) Minutes of audit team discussions, with names of members of audit team present, particularly of the audit partner when he is present.
- 6.7. Matters that give rise to significant risks of a material misstatement are significant matters. Those that causes a revision of the Cost Auditor's previous assessment of the risks of material misstatement is also a significant matter. The Cost Auditor may have reached a certain conclusion regarding the misstatement of the Material Cost in a Cost statement based on the availability of a well documented Bill of Materials but his assessment of risk may undergo a change if he finds that there is considerable use of substitute and alternate materials in the actual production process. Matters that cause the Cost Auditor significant difficulty in applying necessary audit procedures are also significant, as for example heaps of bulk material in irregular shapes which make volumetric measurement of stock in a physical stock taking unreliable. {Refer 5.2(e)}
- 6.8. Determining what are significant matters in an audit to warrant their inclusion in the documentation must be objectively done. The conclusions reached and the application of professional judgment in respect of these also needs to be documented. For example the determination of the normal capacity for applying overheads is a significant matter in Cost Audit and requires not mere calculations but considerable judgment. These should be adequately documented. {Refer 5.2(e)}
- 6.9. Records of discussions include Minutes of discussion of significant matters with management, those charged with governance and others. It also includes Discussion with third parties seeking information or confirmation. (Refer 5.3)

- 6.10. The Cost Audit Documentation in respect of smaller entities may be less detailed than what is indicated but must include at the minimum the following:
- (a) A description of the entity, the products produced, services provided and other activities
 - (b) An organization Chart showing the responsibility centres and the person responsible
 - (c) A description, preferably a flow chart of the manufacturing process
 - (d) Internal controls over material cost, labour cost and expenses
 - (e) The risks of material misstatement assessed, for example, in respect of scrap recovery and disposal
 - (f) Tests of materiality used
 - (g) The overall audit strategy and audit plan
 - (h) Significant matters noted during the audit, and conclusions reached
- 6.11. If, in exceptional circumstances, the Cost Auditor finds it necessary to perform alternative audit procedures different from a corresponding requirement in a Cost Auditing Standards, the Cost Auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure. (Refer 5.4)
- 6.12. It is necessary in a Cost Audit to identify the specific matters or items tested. In connection with a Cost Audit these may include Purchase Orders for supply of key raw materials, Goods Receipt Notes for materials, Issue notes for materials, bills of contractors for supply of contract labour among others. Where the Cost Auditor resorts to test checking, the basis used for selection, for example issues of spares above a certain value, and the documents selected. (Refer 5.5)
- 6.13. Names of the team member preparing specific audit documents and details of their review by the Cost Auditor are a necessary part of the Audit Documentation.
- 6.14. Preparing the audit Documentation on timely basis helps to enhance the quality of audit. Documentation prepared after the audit work has been performed is likely to be less accurate than the documentation prepared during execution. (Refer 5.6)
- 6.15. Facts which become known to the Cost Auditor after the date of the audit report but which if known earlier would have caused the cost statements to be changed or the Cost Audit Report to be modified should be added to the Cost Audit Documentation. The resulting changes to the audit documentation must also be reviewed as the original documentation. (Refer 5.8)
- 6.16. The Cost Audit Documentation must be assembled as the audit goes on and the final assembly required of audited documentation must be limited. Assembly the final audit file should be completed within a reasonable time after the completion of the audit. After the assembly of the final audit file has completed, the auditor should not delete or discard audit documentation of any nature before the end of its retention period. (Refer 5.9)
- 6.17. The audit documentation is the property of the Cost Auditor. Unless otherwise specified by law or regulation, he may at his discretion, make portions of, or extracts from audit documentation available to clients
- 6.18. The Cost Audit Documentation should be retained for at least ten years from the date of the Cost Audit Report.

7. **Effective Date**

This Standard is effective for audits on or after September 11, 2015.

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

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

1. Introduction

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

The independent Cost Auditor is referred to as “Cost auditor” hereafter.

2. Objectives

The objective of this Standard is to lay down the overall objectives of the Cost Auditor and ensuring the Conduct of the Audit of Cost Statements in accordance with the Cost Auditing Standards.

The Cost auditor’s overall objectives are:

- 2.1. *to obtain reasonable assurance about whether the cost statements as a whole are free from material misstatement, whether due to fraud or error, and to enable the auditor to express an opinion whether the Cost Statements are prepared, in all material respects, in accordance with the applicable Cost reporting framework, Cost Accounting Standards (CAS) and Generally Accepted Cost Accounting Principles (GACAP) as issued by the Institute, and give a true and fair view of the Cost of a product, activity or service. In the case of a Cost Audit under the Companies Act and Rules prescribed thereunder, the objective is to express an opinion on whether the Cost Statements subject to audit represent a true and fair view of the cost of production, cost of sales and margin of products covered by the Cost Audit.*
- 2.2. *to report on the cost statements in the form required by law or by the Cost Auditing Standards in accordance with the auditor’s findings.*

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

The Cost Auditors objective may extend to making observations and suggestions where required by applicable regulations.

3. Scope

The scope of this standard is to establish overall objectives of the cost auditor while conducting an audit of cost statements, in accordance with the cost auditing standards.

It also describes management responsibility for the preparation and presentation of the Cost Statement, to identify the Cost Reporting framework and to lay down Cost Accounting policies.

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 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.*
- 4.4. **Audit Team:** *Audit team means all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.*
- 4.5. **Auditee:** *Auditee means a company or any other entity for which cost audit is being carried out.*
- 4.6. **Auditor:** *Auditor is used to refer to the person or persons conducting the audit, usually the audit partner or other members of the audit team, or, as applicable the firm. Auditor includes Cost Auditor*
- 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. **Management:** *The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance.*
- 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. **Non-compliance:** Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations governing Cost Accounting, Cost Records and Cost Audit. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.
- 4.13. **Overall Audit Strategy:** *Overall Audit Strategy sets the scope, timing and direction of the audit, and guides the development of the detailed audit plan.*
- 4.14. **Professional Judgment:** The application of relevant training, knowledge and experience, 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.
- 4.15. **Criticism:** 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.
- 4.16. **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.*
- 4.17. **Those charged with governance:** The person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

5. Requirements

- 5.1. *The cost auditor shall comply with the relevant ethical requirements including those pertaining to independence in respect of cost audit engagements. (refer 6.1)*
- 5.2. *While conducting an audit, the cost auditor shall comply with each of the Cost Auditing Standards relevant to the audit. A Cost Auditing Standard is relevant to the audit when the Cost Auditing Standard is in effect and the circumstances addressed by the Cost Auditing Standard exist. (refer 6.2)*
- 5.3. *The cost auditor shall have an understanding of the entire text of the Cost Auditing Standard, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.*
- 5.4. *The cost auditor shall not represent compliance with the cost auditing standards in the cost auditor's report unless the auditor has complied fully with all of the Cost Auditing Standards relevant to the audit.*

- 5.5. *In exceptional circumstances, the cost auditor may judge it necessary to depart from a relevant requirement in a Cost Auditing Standard. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement.*{Refer 6.2(c)}
- 5.6. *The cost auditor shall plan and perform an audit with an attitude of ticism recognizing that circumstances may exist that cause the Cost Statements to be materially misstated. (refer 6.3)*
- 5.7. *The auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (refer 6.4)*
- 5.8. *The cost auditor shall exercise professional judgment in planning and performing the audit.*
- 5.9. *The cost auditor shall determine whether the Cost Reporting Framework followed by management in preparing cost statements is in line with the Companies Act and the Rules prescribed thereunder. (refer 6.5)*
- 5.10. *The cost auditor shall not be required to perform audit procedures regarding the entity's compliance with laws and regulations governing cost audit in the absence of identified or suspected non-compliance. (refer 6.6)*
- 5.11. *If an objective in a relevant Cost Auditing Standard cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the Cost Auditing Standards, to modify the auditor's opinion.*

6. Application Guidance:

- 6.1 Audit and Ethics:** The cost auditor should comply with relevant ethical requirements as per Code of Ethics issued by the Institute of Cost Accountants of India. This code establishes fundamental principles of professional ethics relevant to the auditor while conducting an audit and provides a conceptual framework for applying these principles. The fundamental principles with which the auditor is required to comply are Independence, Integrity, Objectivity, Professional competence and due care, Confidentiality and Professional conduct. In case of an audit engagement, it is in the public interest that the auditor should be independent of the entity subject to the audit. The cost auditor's independence from the entity safeguards the cost auditor's ability to form an opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity to be objective and to maintain an attitude of ticism. (Refer 5.1)

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

6.2 Conduct of audit: (Refer 5.2)

- (a) The Cost Auditing Standards provide the standards for the cost auditor's work in fulfilling the overall objectives of the cost auditor. The Cost Auditing Standards deal with general responsibilities of the cost auditor, as well as cost auditor's further considerations relevant to the application of those responsibilities to specific topics.
- (b) In performing an audit, the cost auditor may be required to comply with legal or regulatory requirements in addition to Cost Auditing Standards. In such cases in addition to complying with each of the Cost Auditing Standard relevant to the cost audit, it may be necessary for the cost auditor to perform additional audit procedures in order to comply with the legislative and regulatory requirements. The Cost Auditing Standards do not override law or regulations that govern audit process.

The form of the cost auditor's opinion will depend upon the applicable cost reporting framework and any applicable laws or regulations such as Companies Act and Rules prescribed thereunder.

- (c) The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the aim of the requirement. (Refer 5.5)

6.3 Professional Skepticism: An attitude of ticism means the cost auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and be alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. An attitude of ticism is necessary throughout the cost audit process for the auditor to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions from cost audit observations, and of using faulty assumptions in determining the nature, timing and extent of the cost audit procedures and evaluating the results thereof. When making inquiries and performing other cost audit procedures, the cost auditor should not be satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the cost auditor's opinion. (Refer 5.6)

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

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

- (1) The use of sample testing.
- (2) The inherent limitations of internal control (for example, the possibility of management override or collusion).
- (3) The fact that most audit evidence is persuasive rather than conclusive.

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

- (1) The gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and
 - (2) The drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management in preparing the Cost Statements.
- (b) Further, other limitations may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions. (For example, transactions between related parties). In these cases certain Cost Auditing Standard identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:
- (1) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or
 - (2) Any indication that a material misstatement has occurred.

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

Professional skepticism is the state of mind which is ready for the situation that grabs out the errors or questions the financial events and other events while conducting an assurance engagement. It's basically a skill just like the professional judgement which makes the auditor alert for any particular situation. The exercise of professional skepticism is fundamental to the successful performance of auditors, audit firms, and the audit profession as a whole in discharging their responsibilities to the stakeholders of business entity and the society at large.

Professional Skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information and explanations obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example, in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

The auditor should also apply professional skepticism when forming the auditor's opinion, by considering the overall sufficiency of evidences and explanations provided by management to support the audit opinion, and by evaluating whether the financial statements overall are a fair presentation of underlying transactions and events and the financial state of affairs of the company. The challenge for audit firms is to identify, develop and retain people with the necessary skills to undertake audits with a sceptical mind-set. It also involves nurturing the conditions that allow professional skepticism to flourish, which in turn helps professionals to discharge her/his duties and responsibilities.

The three elements of professional skepticism —auditor attributes, auditor mindset, and auditor actions permeate the entire audit process and are integral to audit quality. These elements of professional skepticism interact dynamically as auditors respond to conditions and pressures that change or arise during the audit.

The purpose of an audit is to provide investors, lenders and other stakeholders with an opinion that management prepared financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. It will impair the value of audit without professional skepticism. So it's in one's best interests to understand what professional skepticism means and how to apply it throughout the attestation process.

Professional skepticism also plays a critical role in an auditor's consideration of fraud. Where the risk of fraud is high, an auditor might modify planned audit procedures to gather more reliable evidence in support of financial statement assertions. For example, an auditor might obtain confirmation from an independent third party, engage a specialist or examine documentation from independent sources to corroborate management representations. If required, tools and techniques of forensic audit may also be applied.

Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of:

- Overlooking unusual circumstances.
- Over generalizing when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof.

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

- (a) The cost auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the Cost Statements give a true and fair view or in accordance with the applicable cost reporting framework. The concept of reasonable assurance acknowledges that there is a risk the audit opinion is inappropriate. The risk that the cost auditor expresses an inappropriate audit opinion when the Cost Statements are materially misstated is known as “audit risk.” The cost auditor reduces audit risk by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level.
- (b) Audit risk is a function of the risk of material misstatement in the cost statements (or simply, the “risk of material misstatement”) (i.e., the risk that the Cost Statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement (“detection risk”). The cost auditor performs audit procedures to assess the risk of material misstatement and seeks to limit detection risk by performing further audit procedures based on that assessment. The audit process involves the exercise of professional judgment in designing the audit approach, through focusing on what can go wrong (i.e., what are the potential misstatements that may arise) at the assertion level and performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence.
- (c) The cost auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the Cost Statements taken as a whole. The cost auditor considers whether the effect of identified uncorrected misstatements, both individually and in the aggregate, is material to the Cost Statements taken as a whole. Materiality and audit risk are related.

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

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

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

(f) The risk of material misstatement at the assertion level consists of two components as follows:

(1) “Inherent risk” is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls. The risk of such misstatement is greater for some assertions and related cost heads, items of cost and disclosures than for others. For example, complex calculations are more likely to be misstated than simple calculations. Cost heads consisting of amounts derived from cost estimates that are subject to significant measurement uncertainty pose greater risks than do cost heads consisting of relatively routine, factual data.

External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a cause changes to a manufacturing process rendering the existing classification of variable and fixed costs inappropriate and cause product contribution to be misstated. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that relate to several or all of the classes of cost heads, items of cost, or disclosures may influence the inherent risk related to a specific assertion. These latter factors include, for example, external market constraints may cause normal capacity as an unreliable basis for determining unit costs.

(2) “Control risk” is the risk that a misstatement that could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control. That risk is a function of the effectiveness of the design and operation of internal control in achieving the entity’s objectives relevant to preparation of the entity’s Cost Statements. Some control risk will always exist because of the inherent limitations of internal control.

Inherent risk and control risk are the entity’s risks; they exist independently of the audit of the Cost Statements. The auditor is required to assess the risk of material misstatement at the assertion level as a basis for further audit procedures, though that assessment is a judgment, rather than a precise measurement of risk. When the auditor’s assessment of the risk of material misstatement includes an expectation of the operating effectiveness of controls, the auditor performs tests of controls to support the risk assessment. The Cost Auditing Standard do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risk of material misstatement.” Although the Cost Auditing Standard ordinarily describe a combined assessment of the risk of material misstatement, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risk of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

(g) “Detection risk” is the risk that the cost auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other misstatements.

Detection risk is a function of the effectiveness of an audit procedure and of its application by the auditor. Detection risk cannot be reduced to zero because the auditor usually does not examine all of cost heads, items of cost, or disclosure and because of other factors. Such other factors include the possibility that a cost auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through adequate planning, proper assignment of personnel to the audit team, the application of criticism, and supervision and review of the audit work performed.

Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level.

For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risk of material misstatement at the assertion level. The greater the risk of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risk of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.

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

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

- (a) The requirements of the Cost reporting framework determine the form and content of the Cost Statements and what constitutes a complete set of Cost Statements. For certain Cost reporting frameworks, a single cost statement as such and the related explanatory notes constitute a complete set of Cost Statements. For example: a Cost Statement under Cost Accounting Standard 4.
- (b) The Cost auditor is not responsible for preparing and presenting the cost statements in accordance with the applicable Cost reporting framework including inter-alia:
 - (1) Designing, implementing and maintaining internal control relevant to the preparation and presentation of Cost Statements that are free from material misstatement, whether due to fraud or error;
 - (2) Selecting and applying appropriate Cost accounting policies; and
 - (3) Making cost estimates that are reasonable in the circumstances.

6.6 Non-compliance: The cost auditor shall request management to provide written representation that all known instances of non-compliance or suspected non - compliance with laws and regulations governing Cost Accounting, Cost Records and Cost Audit have been disclosed to the cost auditor. The representations provide necessary audit evidence about management knowledge of identified or suspected non-compliance with laws and regulations whose effects may have a material effect on the cost statement however, written representation do not provide sufficient audit evidence on their own, and accordingly do not affect the nature and extent of other audit evidence that is to be obtained by the cost auditor. (Refer 5.10)

7. Effective Date

This Standard is effective for audits on or after September 11, 2015.

Cost Auditing Standard on Knowledge of Business, its Processes and the Business Environment - 104

The following is the *Cost Auditing Standard (Cost Auditing Standard - 104)* on “**Knowledge of Business, its Processes and the Business Environment**”. 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

In performing an audit of cost statement, records and other related documents, the cost auditor should have the knowledge of the client’s business to enable him to understand the processes and express his opinion on the cost statements.

The cost auditor’s level of knowledge for a cost audit engagement should include a general knowledge of the economy and the industry within which the entity operates, and a more particular knowledge of how the entity operates.

2. Objective

The objective of this standard is to enable the cost auditor to have knowledge of the client’s business which is sufficient to identify and understand the events, transactions and practices that, in the cost auditor’s judgment may have a significant effect on the examination of cost statements or on the preparation of the cost audit report.

3. Scope

This standard deals with obtaining the knowledge of the client’s business, its processes and business environment as it is important for the cost auditor and members of the audit team working on an audit engagement.

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 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 risk.*
- 4.3 *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.*

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

4.5 **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 sub-section (1) of section 6 and who is deemed to be in practice under sub-section (2) of section 2 of that Act and includes a firm of cost accountants.*

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

4.7 **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 **The Cost Auditor shall have adequate level of understanding of the knowledge of Business, its Processes and the Business Environment to develop a reasonable assurance in order to express an opinion on the cost statements on which he is expressing an opinion.**(refer 6.1)

5.2 **The Entity and Its Environment:** *The cost auditor should obtain an understanding of the following:*

(a) *The nature of the entity, (including its operations covering Business processes, major inputs, Joint & By-Products and Wastages and major outputs etc) and the entity’s ownership and governance structure.*

(b) *Relevant industry, regulatory, and other external factors including the applicable cost and financial reporting framework.*(refer 6.2)

(c) *The entity’s selection and application of cost accounting policies.*(refer 6.3)

(d) *The measurement and review of the entity’s performance.* (refer 6.4)

5.3 **The Entity’s Internal Control:** *The cost auditor shall obtain an understanding of internal controls relevant to the audit.* (refer 6.5)

(a) **Control Environment:** *The cost auditor shall evaluate whether management has created and maintained a culture of honesty and ethical behaviour.*

(b) **The entity’s risk assessment process:** *The cost auditor shall obtain an understanding of whether the entity has a process for: (refer 6.6, 6.7, 6.8)*

(1) *Identifying business risks relevant to cost reporting objectives;*

(2) *Assessing the likelihood of their occurrence;*

(3) *Estimating the significance of the risks; and*

(4) *Deciding about actions to address those risks.*

- (c) *Cost Information System/ Management Information System: The cost auditor shall obtain an understanding of the Information System including Management Information System, relevant to cost reporting, including the following areas: (refer 6.9)*
 - (1) *The classes of transactions and their analysis, that are significant to the cost statements;*
 - (2) *The procedures, by which those transactions and their analysis are initiated, recorded, processed, and reported in the management information systems and cost statements;*
 - (3) *The related cost accounting records, supporting information that are used to initiate, record, process and report transactions; and*
 - (4) *The reporting process used to prepare the entity's cost statements, including significant estimates and disclosures.*
- (d) *Control Activities: The auditor shall obtain an understanding of the control activities, relevant to the audit.(refer 6.10)*
- (e) *Monitoring of controls:*
 - (1) *The auditor shall obtain an understanding of the major activities, that the entity uses to monitor internal control over reporting.(refer 6.11)*
 - (2) *The cost auditor shall evaluate the adequacy of the internal audit function in relation to cost records. (refer 6.12)*

5.4 IT (Information Technology) Environment and Control: The cost auditor shall evaluate and assess: (refer 6.13)

- (1) *IT Architecture, Systems and programmes in use in the entity;*
- (2) *Controls on access to data;*
- (3) *Controls on changes to data in master files, systems or programmes; and*
- (4) *Integrity of information and security of the data*

5.5 Identifying and Assessing the Risks of Material Misstatement: The cost auditor shall identify and assess the risks of material misstatement at the cost statement level; and at the assertion level including items of cost, cost heads and disclosures thereof.

For this purpose, the cost auditor shall: (refer 6.14, 6.15, 6.16)

- (1) *Identify risks including relevant controls that relate to the risk of material misstatements or a risk of fraud;*
- (2) *Assess whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;*
- (3) *Assess whether the risk involves significant transactions with related parties;*
- (4) *Assess the degree of subjectivity in the measurement of information related to the risk.*
- (5) *Assess whether there arises a need for revising the assessment of risk based on additional audit evidence obtained.*

5.6 Documentation: The auditor shall document:

- (a) *Key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 5.1 & 5.2 above and of each of the internal control components specified in paragraphs 5.3 above; the sources of information from which the understanding was obtained; and the risk assessment procedures performed;*
- (b) *The identified and assessed risks of material misstatement at the cost statement level and at the assertion level including items of cost, cost heads and disclosure thereof as required by paragraph 5.5 above; and*
- (c) *The risks identified, and related controls about which the auditor has obtained an understanding, as a result of the requirements in paragraphs 5.5 above.*

6. Application Guidance

- 6.1 Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous and dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the cost auditor plans the audit and exercises professional judgment throughout the audit, for example, when: (Refer 5.2)
- (a) Assessing risks of material misstatement of the cost statements;
 - (b) Considering the appropriateness of the selection and application of cost accounting policies, and the adequacy of cost statement disclosures;
 - (c) Identifying areas where special audit consideration may be necessary, for example, abnormal losses, lower yields, higher wastages, higher utilities consumption, related party transactions etc.
 - (d) Developing Models for use in performing analytical procedures;
 - (e) Responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence; and
 - (f) Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of management's oral and written representations.
- 6.2 Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments etc. Examples of matters the cost auditor may consider include: {Refer 5.2(b)}
- (a) The market and competition
 - (b) Cyclical or seasonal activity
 - (c) Changes in product technology
 - (d) Business risk (for example, high technology, high fashion, ease of entry for competition)
 - (e) Declining or expanding operations
 - (f) Adverse conditions (for example, declining demand, excess capacity, serious price competition)
 - (g) Key ratios and operating statistics

- (h) Specific cost accounting practices and problems
 - (i) Specific or unique practices (for example, relating to labour contracts, financing methods, accounting methods).
 - (j) Energy supply sources and cost
 - (k) Environmental requirements and problems
- 6.3 An understanding of the entity's selection and application of cost accounting policies may encompass matters such as: {Refer 5.2(c)}
- (a) The methods the entity uses to account for significant and unusual transactions (abnormal events).
 - (b) The effect of significant cost accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.
 - (c) Changes in the entity's cost accounting policies.
 - (d) Cost reporting framework, and laws and regulations that are new to the entity and when and how the entity will adopt such requirements.
- 6.4 Management will measure and review those things they regard as important. Performance measures, whether external or internal, create pressures on the entity. These pressures, in turn, may motivate management to take action to improve the business performance or to misstate the cost or financial statements. Accordingly, an understanding of the entity's performance measures assists the cost auditor in considering whether pressures to achieve performance targets may result in management actions that increase the risks of material misstatement, including those due to fraud. Examples of internally-generated information used by management for measuring and reviewing financial performance, and which the cost auditor may consider, include: {Refer 5.2(d)}
- (a) Key performance indicators and key ratios (financial and non-financial).
 - (b) Key trends and operating statistics.
 - (c) Period-on-period financial performance analyses.
 - (d) Budgets, forecasts, variance analyses, segment information and divisional, departmental or other unit level performance reports.
 - (e) Employee performance measures and incentive compensation policies.
 - (f) Comparisons of an entity's performance with that of competitors.
- 6.5 While understanding controls that are relevant to the audit, cost auditor should evaluate the design of those controls and determine whether they have been implemented properly, by performing procedures in addition to discussions with the entity's personnel.(Refer 5.3)
- 6.6 If the entity has established risk assessment process, the cost auditor should obtain an understanding of it, and the results thereof. If the cost auditor identifies risks of material misstatement that management failed to identify, the cost auditor should evaluate whether there was an underlying risk of a kind that the cost auditor expects would have been identified by the entity's risk assessment process. If there is such a risk, the cost

auditor should obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or determine if there is a significant deficiency in internal control with regard to the entity's risk assessment process. {Refer 5.3(b)}

- 6.7 As part of the risk assessment, the cost auditor should determine whether any of the risks identified are, in the cost auditor's judgment, a significant risk. In exercising this judgment, the cost auditor should exclude the effects of identified controls related to the risk. {Refer 5.3(b)}
- 6.8 An understanding of the business risks facing the entity increases the likelihood of identifying risks of material misstatement, since most business risks will eventually have financial consequences and, therefore, an effect on the cost statements. However, the cost auditor does not have a responsibility to identify or assess all business risks because not all business risks give rise to risks of material misstatement. {Refer 5.3(b)}
- 6.9 The cost auditor should understand the related cost accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred primarily to the accounting system and subsequently to cost accounting statement. {Refer 5.3(c)}
- 6.10 The cost auditor should obtain an understanding of control activities relevant to cost/ management information system in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions and disclosure in the cost statements or to every assertion relevant to them. {Refer 5.3(d)}
- 6.11 The cost auditor should obtain an understanding of the major activities that the entity uses to monitor internal control relevant to cost reporting, including those related to those control activities relevant to the audit, and how the entity initiates remedial actions to deficiencies in its controls. {Refer 5.3(e)(1)}
- 6.12 If an entity has an internal audit function, inquiries of the appropriate individuals within the function may provide information that is useful to the cost auditor in obtaining an understanding of the entity and its environment, and in identifying and assessing risks of material misstatement at the cost statement and assertion levels. If based on responses to the cost auditor's inquiries, it appears that there are findings that may be relevant to the entity's audit; the cost auditor may consider it appropriate to read related reports of the internal audit function. {Refer 5.3(e)(2)}
- 6.13 The cost auditor should assess the following with regard to IT environment and controls. (Refer 5.4)
- (a) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
 - (b) Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
 - (c) The possibility of IT personnel gaining access to privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
 - (d) Unauthorized changes to data in master files.

- (e) Unauthorized changes to systems or programs.
 - (f) Failure to make necessary changes to systems or programs.
 - (g) Inappropriate manual interventions.
 - (h) Potential loss of data or inability to access data as required.
- 6.14 Risks at the cost statement level may derive in particular from a deficient control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as management's lack of competence may have a more pervasive effect on the cost statements and may require an overall response by the auditor. (Refer 5.5)
- 6.15 Risks of material misstatement at the cost statement level refer to risks that relate pervasively to the cost statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level, for example, through management override of internal control. Cost statement level risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud. (Refer 5.5)
- 6.16 The auditor's assessment of the identified risks at the assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that only by performing tests of controls may the auditor achieve an effective response to the assessed risk of material misstatement for a particular assertion. (Refer 5.5)

7. **Effective Date**

This Standard is effective for audits on or after September 11, 2015.

Exercise

A. Theoretical Questions

⊙ Multiple Choice Questions

1. _____ Cost Auditing Standard deals with planning an audit of Cost Statement.
(a) 101
(b) 102
(c) 103
(d) 104
2. Total _____ Cost Auditing Standards have been issued by Cost Auditing Standard Board.
(a) 1
(b) 2
(c) 3
(d) 4
3. Objective of Cost Auditing Standard _____ is to guide members in planning for the audit of Cost Statements.
(a) 101
(b) 102
(c) 103
(d) 104
4. Which Cost Auditing Standard requires Cost Auditor to prepare audit documentation on timely basis?
(a) 101
(b) 102
(c) 103
(d) 104
5. Which Cost Auditing Standard requires Cost Auditor to develop an audit plan?
(a) 101
(b) 102
(c) 103
(d) 104

6. Which Cost Auditing Standard requires Cost Auditor to evaluate and assess IT Environment and Control?
 - (a) 101
 - (b) 102
 - (c) 103
 - (d) 104

7. Who has issued Cost Auditing Standards?
 - (a) Cost Accounting Standard Board
 - (b) Cost Auditing & Assurance Standard Board
 - (c) Technical Cell
 - (d) Internal Auditing and Assurance Standard Board

8. Which Section of Companies Act,2013 provides that Cost Auditor should comply with Cost Auditing Standards?
 - (a) 25
 - (b) 50
 - (c) 125
 - (d) 148

9. Who is the approving authority of Cost Auditing Standards?
 - (a) Ministry of Finance
 - (b) Ministry of External Affairs
 - (c) Ministry of Corporate Affairs
 - (d) Ministry of Coal & Mining

10. Which Cost Auditing Standards requires Cost Auditor for forming and expressing an opinion on the Cost Statements?
 - (a) 101
 - (b) 102
 - (c) 103
 - (d) 104

11. On which date, Cost Auditing Standards 101 to 104 are approved by Ministry of Corporate Affairs?
 - (a) 10.07.2015
 - (b) 10.08.2015
 - (c) 10.09.2015
 - (d) 10.10.2015

12. How many members Cost Auditing Standard Board has?
- (a) 5
 - (b) 7
 - (c) 11
 - (d) 14

⊙ **State True or False**

1. Cost Auditing Standards are issued by Central Government in consultation with the Institute of Cost Accountants of India, constituted under the Cost and Works Accountants Act, 1959.
2. The Cost Accounting Standards Board [CASB] of the Institute of the Cost Accountants of India formulates the Cost Auditing Standards.
3. The International Auditing and Assurance Standards Board (IAASB) is established under the authority of International Federation of Accountants (IFAC) and The Institute of Cost Accountants of India is a founder member of IFAC.
4. An Engineering expert has been engaged by the cost auditor in connection with the audit of an entity. He will also be considered as a part of the Audit Team.
5. Audit working papers provide assurance that the audit has been performed in accordance with the relevant Cost Accounting Standards and GACAP.
6. Cost auditing standards are advisory in nature.

⊙ **Fill in the Blanks**

1. Cost Auditing Standard 104 on Knowledge of business, its processes and the business environment was issued on _____ and is effective from _____ .
2. The Cost Auditing Standard 102 relates to _____ .
3. A company or any other entity for which cost audit is being carried out is called _____ .
4. It is the responsibility of _____ for the preparation and presentation of Cost Statements,
5. Cost Auditing standards are issued in terms of section _____ of Companies Act, 2013.

⊙ **Short Essay Type Questions**

1. Explain the meaning of:
 - a. Initial Audit
 - b. Misstatement
 - c. Audit documentation

2. Write briefly as to how do you assess that the appointment of the cost auditor is proper.
3. What are the factors which a new cost auditor is to consider while formulating the overall strategy of cost audit of a company?
4. What do you understand by audit risk? Explain in brief.

Answer:

Multiple Choice Questions

1.	(a) 101
2.	(d) 4
3.	(a) 101
4.	(b) 102
5.	(a) 101
6.	(d) 104
7.	(b) Cost Auditing and Assurance Standard Board
8.	(d) 148
9.	(c) Ministry of Corporate Affairs
10.	(c) 103
11.	(c) 10.09.2015
12.	(c) 11

State True or False

1.	False - Cost auditing standards are issued by the Institute of Cost Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.
2.	False - The Cost Audit & Assurance Standards Board [CAASB] of the Institute of the Cost Accountants of India formulates the Cost auditing standards.
3.	True
4.	True
5.	False - Audit working papers provide assurance that the audit has been performed in accordance with the relevant Cost Auditing Standards.
6.	False - Cost auditing standards are mandatory in nature.

Fill in the Blanks

1.	10 th September, 2015, 11 th September, 2015
2.	Cost Audit Documentation
3.	Auditee
4.	Company Management
5.	Section 148 (3)