Module 3 · The Cost Auditor P17 · topics 3.1–3.6

SM pp. 95–122. **66 marks in 7 papers. Q3(a), 7 marks, in every paper** (appointment and remuneration, KMP / independent director, qualifications and disqualifications, fraud reporting, steps before accepting, professional misconduct), plus 1–2 MCQs (10-year fraud bar, ADT-3, s.442 panel, 180 days).

Paper	Q3(a) long question · MCQs
Jun'23	Q3(a) **fundamental principles of professional ethics** (6) · MCQs: fraud reported under s.143(12); appointment within 180 days
Dec'23	Q3(a) **appointment and remuneration procedure** · MCQs: s.148(3); casual vacancy on death → 30 days
Jun'24	Q3(a) **cost accountant as KMP / independent director** · MCQ: fraud conviction → 10-year bar
Dec'24	Q3(a) **qualifications and disqualifications** · MCQ: what is not professional misconduct
Jun'25	Q3(a) **duty to report fraud** (= PTP Q3(a)) · MCQ: resigning auditor files ADT-3
Dec'25	Q3(a) **steps before accepting appointment** · MCQs: mediation and conciliation panel s.442; who cannot be appointed
Jun'26	Q3(a) **professional misconduct, First Schedule** of the CWA Act

DEC'26 PREDICTION · Q3(a), 7 MARKS, CERTAIN

- (1) **Eligibility: who is eligible and who cannot be appointed** (s.141 + Rule 10 + s.148; ICMAI MQP Q3(a)); (2) **fraud reporting** under s.143(12) again (PTP); (3) appointment and remuneration; (4) **rights and duties, removal** (never asked long).
- MCQs: 10 years · 20 companies · ₹1 lakh / ₹5 lakh / ₹1 lakh · 30 days · ADT-3 · s.143(12) penalty · s.447 / 448.
- Q3(a) can also be Module 1 or 6; Module 3 had it in all 7 papers.

MAP

1. 3.1 Who is a cost auditor ★
2. 3.2 Eligibility and disqualifications ★★★
3. 3.2 Appointment, remuneration, removal, resignation ★★★
4. 3.2 Rights, duties, CRA-3 report contents ★★
5. 3.2 Strategic positions (KMP, ID, tribunals) ★★
6. 3.2 Liabilities ★
7. 3.3 Professional ethics ★★
8. 3.4–3.6 Fraud reporting, s.447, s.448, misconduct ★★★
9. SM exercise · numbers

3.1 Definition

SM WORDS **"Cost auditor"** means a **Cost Accountant in practice**, as defined in clause (b), **who is appointed by the Board** [Rule 2(c)]. A Cost Accountant in practice: a member under s.2(1)(b) of the **Cost and Works Accountants Act, 1959** holding a valid **certificate of practice** (s.6(1)), incl. a **firm or LLP** of cost accountants [Rule 2(b)]. **s.22** of the CWA Act: "professional or other misconduct" includes any act or omission in the **Schedules** (an illustrative list). [SM 95]

3.2 Eligibility, qualifications, disqualifications · Dec'24 Q3(a), MQP Q3(a), Dec'25 MCQ

THE LEGAL ROUTE

- No separate sections for the cost auditor except **s.148**; **s.148(5)**: the qualifications, disqualifications, rights, duties and obligations of the financial auditor (ss.139–147) apply **so far as may be applicable**, read with the Companies (Audit and Auditors) Rules, the CRA Rules and the CWA Act. [SM 96]
- **Qualifications:** (1) a **cost accountant** [s.148(3)]; (2) member under the CWA Act holding a certificate of practice [s.2(28)]; (3)–(4) member = name on the Register; (5) satisfies **s.141** [Rule 6(1A)(b)]; (6) a **firm** may be appointed in its name if a **majority of its partners practising in India** are qualified; (7) only partners who are cost accountants act and sign for a firm or LLP. [SM 97–98]
- **No rotation**: s.139(3) rotation is only for statutory auditors; companies (e.g. PSUs) may rotate as policy (SM T/F 2). [SM 101]

NOT ELIGIBLE · s.141(3) + RULE 10 + s.148

a. a **body corporate**, other than an **LLP**;
b. an **officer or employee** of the company;
c. a **partner or employee of an officer or employee**;
d. he, his relative or partner: holds **securities or interest** in the company or its group (a **relative** may hold up to **₹1 lakh** face value); is **indebted** to it above **₹5 lakh**; has given a **guarantee or security** for a third person's debt to it above **₹1 lakh**;
e. a **business relationship** with the company or its group (except permitted professional services and arm's-length ordinary-course sales);
f. a **relative** is a director or KMP;
g. in **full-time employment elsewhere**, or auditor of **more than twenty companies**;
h. **convicted of an offence involving fraud** and **ten years** have not elapsed (Jun'24 MCQ; SM MCQ 13);
i. renders **s.144 services**: accounting and book-keeping, internal audit, financial information systems, actuarial,

investment advisory, investment banking, outsourced financial services, management services.

[SM 96–99]

A disqualification incurred after appointment → he **vacates office**; a **casual vacancy** [s.141(4), Rule 6(3A)]. The **statutory auditor** (s.139) cannot be the cost auditor [s.148(3)]. [SM 99]

3.2 Appointment, remuneration, removal, resignation · Dec'23 + Dec'25 Q3(a)

BEFORE written **consent** + **certificate** (Rule 6(1A)) → **BOARD** appoints within **180 days** of FY start, on the **audit committee's** recommendation → **CRA-2** 30 days of Board meeting or 180 days of FY, earlier → **FEE** Board approves; **shareholders ratify** → **TENURE** 180 days after FY end or till the report

[SM 99–101]

STEPS BEFORE ACCEPTING (DEC'25 Q3(a)) · RULE 6(1A) CERTIFICATE

a. he or the firm is **eligible and not disqualified** under the Act, the CWA Act and their rules;

b. satisfies the criteria of **s.141**, so far as applicable;

c. the appointment is **within the limits** laid down by the Act;

d. the **list of pending proceedings** on professional conduct against him, the firm or any partner is true and correct.

[SM 99]

Then **written consent**; the company informs him and files **CRA-2**. [SM 99]

REMUNERATION (RULE 14, AUDIT AND AUDITORS RULES) · DEC'23 Q3(a)

- **With an audit committee:** the Board appoints the cost auditor **on the audit committee's recommendation**, which also recommends his remuneration; the Board **considers and approves** it; the **shareholders ratify** it subsequently (SM T/F 5: True). [SM 101]
- **Without one:** the Board appoints; the **remuneration is ratified by the shareholders**. [SM 101]

REMOVAL, CASUAL VACANCY, RESIGNATION

- **Removal** before the term: by **Board resolution**, after a **reasonable opportunity of being heard**, with **reasons recorded in writing** (not by the audit committee: SM T/F 3); new CRA-2 with the resolution. [SM 100–101]
- **Casual vacancy** (resignation, death, removal): Board fills it within **thirty days**; CRA-2 within thirty days of the appointment (Dec'23 MCQ). [SM 100]
- **Resignation**: statement in **Form ADT-3** with the company and the registrar **within 30 days** [s.140(2), Rule 8] (Jun'25 MCQ); default: fine **₹50,000** to **₹2 Lakh**. [SM 100]

RIGHTS AND DUTIES (s.143 + s.148(5))

- s.143 applies *mutatis mutandis* to the cost accountant doing cost audit [s.143(14)]. The company gives **all assistance and facilities**; the auditor **complies with cost auditing standards**; report to the **Board**. [SM 102]
- **CRA-3 must state:** (a) all information and explanations obtained; (b) proper cost records kept per Rule 5; (c) adequate returns from **branches not visited**; (d) books give the information required; (e) adequate **internal audit of cost records**; (f) the annexure gives a **true and fair view** of cost of production, cost of sales, margin; (g) unit-wise and product-wise cost statements are kept. [SM 102]

3.2 Strategic positions for cost accountants · Jun'24 Q3(a) · liabilities

- **KMP (s.203)**: MD/CEO/manager (or whole-time director), company secretary, CFO; a cost accountant's credentials qualify him to be a **KMP**. [SM 104]
- **Independent director**: s.149(4) — at least **one-third** of the board of listed companies; Rule 5 needs expertise in finance, law, management, sales, marketing, administration, research, governance or technical operations → a cost accountant is eligible. [SM 104]
- **Technical member, NCLT** (s.409(3)): practising cost accountant of at least **fifteen years**; **NCLAT** (s.411(3)): over **25 years**. [SM 104]
- **Company liquidator** (s.275(2)) from the CG's panel (at least **10 years** of corporate experience) · **administrator** (s.259) · **expert** (s.2(38)); **SFIO** experts incl. **forensic audit** (s.211(2)) · **registered valuer** (s.247) · appear before **NCLT/NCLAT** (s.432) · **mediation and conciliation panel** (s.442: rules yet to be notified; Dec'25 MCQ). [SM 104–106]

LIABILITIES

- **Civil:** misstatement in prospectus as an expert (s.35); **misfeasance** at liquidation (s.340). [SM 106]
- **Criminal:** prospectus (s.34 → s.447); **s.147** breach of ss.139, 144, 145: fine **₹25,000** to **₹5,00,000** or **four times** remuneration, whichever less; wilful: up to **1 year** and **₹50,000** to **₹25,00,000** or **eight times**, whichever less, plus refund and damages; firm and partners jointly for fines. [SM 106–107]
- s.217 refusing documents to an inspector; s.336 fraud in winding up (**three to five years**); s.448 false statement → s.447; **s.449 false evidence**: three to seven years, fine up to ten lakh. [SM 107]
- Other Acts: Income-tax s.278; CWA Act Schedules; LIC Act s.104; BR Act s.46. **Contractual**: Contract Act; *Wilde v. Cape and Dalgeish* (1897). [SM 108]

3.3 Professional ethics · Jun'23 Q3(a)

The profession's objectives need four **basic needs**: (a) **credibility** in information and systems; (b) **professionalism**; (c) **quality of service**; (d) **confidence** in a framework of ethics. [SM 109]

In addition, a cost accountant in practice should **be and appear to be free** of any interest incompatible with integrity, objectivity and **independence**. [SM 109]

FIVE FUNDAMENTAL PRINCIPLES (SM WORDS)

a. **Integrity**: straightforward and honest.
b. **Objectivity**: fair; no prejudice, bias or influence of others.
c. **Competence**: refrain from a service he is not competent to do, unless proper advice and assistance is obtained.
d. **Confidentiality**: no disclosure or use without proper and specific authority or a legal or professional duty.
e. **Professional behaviour**: consistent with the good reputation of the profession.

[SM 109]

3.4–3.5 Duty to report fraud · s.447 · Jun'25 Q3(a), PTP Q3(a), Jun'23 MCQ

- SM WORDS **s.143(12)**: if an auditor, in the course of his duties, has **reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees**, he shall report it to the **Central Government** within the prescribed time and manner. [SM 110]
- Below the Rule 13 amount: report to the **audit committee** (s.177) or the **Board**; the company then discloses it in the **Board's report**. [SM 103–104]
- **s.143(13)**: no breach of duty if reported in **good faith**. **s.143(14)**: applies to cost accountants (s.148) and company secretaries (s.204). [SM 104, SM 110]
- Report **immediately but not later than 2 days** of his knowledge: (a) **nature** of fraud with description; (b) approximate **amount**; (c) **parties** involved. Board's report: (a)–(c) + **remedial action** taken. [SM 110]

⚠ PENALTY: THE SM GIVES TWO FIGURES

SM 110 (old s.143(15)): fine **one lakh** to **twenty-five lakh** rupees (SM MCQ 2 key: ₹25 lakh). SM 104 (as amended in 2020): **penalty ₹5 lakh** for a **listed** company, **₹1 lakh** for others. Write the amended figures and mention the old ones. [SM 104, SM 110, SM 122]

⚠ NOT IN THE SM: RULE 13 THRESHOLD AND FORM

Rule 13 of the Companies (Audit and Auditors) Rules: fraud of **₹1 crore or above** → report to the Central Government (Form **ADT-4**): to the Board / audit committee within **2 days**, their reply within **45 days**, then to the CG within **15 days**; below ₹1 crore → audit committee or Board within 2 days.

s.447 PUNISHMENT FOR FRAUD

- SM WORDS Imprisonment **not less than six months**, up to **ten years**, and fine **not less than the amount involved**, up to **three times** the amount; if **public interest** is involved, imprisonment **not less than three years**. [SM 111]
- Fraud of at least **ten lakh** rupees or **one per cent of turnover**, whichever is lower, gets that punishment; smaller frauds without public interest: up to **five years** or fine up to **fifty lakh** or both. [SM 106]
- **"Fraud"**: any act, omission, concealment of fact or abuse of position, with intent to **deceive, gain undue advantage, or injure** the company, its shareholders, creditors or others, **whether or not there is wrongful gain or loss**. [SM 111]

s.448 FALSE STATEMENT (MQP MCQ)

A statement in any return, report, certificate, financial statement, prospectus or other document that is (a) **false in any material particular, knowing it to be false**, or (b) **omits a material fact**, knowing it to be material → liable under **s.447** (SM fill-in 3). [SM 112]

3.6 Professional and other misconduct · CWA Act Schedules · Jun'26 Q3(a), Dec'24 MCQ

FIRST SCHEDULE · PART I · IN PRACTICE (JUN'26 Q3(a))

1. allows a non-cost-accountant to **practise in his name**;
2. **shares fees** or profits with a non-member (other than partners, retired partners, legal representatives);
3. **accepts profits** of the work of a non-member (except permitted arrangements);
4. enters **partnership** with persons other than cost accountants in practice or prescribed professionals;
5. **secures work** through non-employees or by means not open to a cost accountant;

SECOND SCHEDULE · PART I · IN PRACTICE

1. **discloses client information** without consent or legal requirement;
2. **certifies a report** not examined by him, a partner, an employee or another practising cost accountant;
3. lends his name to a **forecast** as if he vouched for it;
4. gives an opinion where he has a **substantial interest**;
5. fails to **disclose a material fact**;
6. fails to report a **material misstatement**;
7. lacks **due diligence** or is **grossly negligent**;

6. **solicits** clients by circular, advertisement, personal communication or interview (but may respond to **tenders** and invite work from other cost accountants);
7. **advertises** or uses designations other than "cost accountant" (a write-up per Council guidelines is allowed).

[SM 112–113]

Part II (in service): shares emoluments; accepts commission from the employer's lawyers, brokers, agents. **Part III (generally):** acts as a fellow when not one; does not supply information to the Institute; gives false information when inviting work. **Part IV (other misconduct):** held guilty for an offence punishable with imprisonment **not exceeding six months**; brings disrepute. [SM 113–114]

8. fails to obtain **sufficient information** for an opinion;
9. fails to point out **departures from accepted costing procedure**;
10. does not keep client money in a **separate bank account**.

[SM 114–115]

Part II: contravenes the Act or Council guidelines; discloses employer's confidential information; gives false particulars to the Institute; **defalcates or embezzles**. **Part III:** held guilty for an offence punishable with imprisonment **exceeding six months**. **Penalties:** s.24 falsely claiming membership, s.25 using the Institute's name: up to **one thousand** rupees; repeat up to six months / five thousand; **s.26** a **company may not practise** as cost accountants (SM fill-in 2); s.27 unqualified persons may not sign; s.29 prosecution only on a complaint of the Council or the CG. [SM 115–117]

SM SOLVED CASE · APPLICABILITY WITH SCRAP AND BY-PRODUCT (NON-REGULATED, TURNOVER ₹159 CRORE)

CTA 7401 waste and scrap ₹46 cr · 7405 product ₹57 cr · 7406 by-product ₹56 cr. Opinion: total turnover above **₹100.00 crores** and the main product above **₹35.00 crores** → records and audit apply, but **only to the main product (7405)**; scrap is not a product; a by-product sold as such is credited to the main product's cost; a separate statement is needed only if it is **further processed**. [SM 117–118]

EX The SM's own exercise (SM 119–122) · numbers

1 appointment under	**s.148(3)**	8 audit of efficiency, performance, propriety	**cost audit**
2 maximum fine, s.143(12) breach	**₹25 lakhs** (old; ⚠ above)	9 the 2014 Rules superseded	**Cost Accounting Records Rules, 2011**
3 fraud reported under	**s.143(12)** (= Jun'23 MCQ)	11 appointment for FY 2023-24	**by 27.09.2023**
4 appoint within ★	**180 days**	13 fraud conviction bar ★	**10 years**
5 report filed within (SM key)	**180 days** of FY end	fill-ins: rights and duties s.**143**; companies barred s.**26** CWA Act; false report s.**447**	relative's securities ₹**1** lakh; casual vacancy **30** days
6 officer not eligible	**s.141**	7 same powers as s.143 auditor	**s.148**

Rule	Number	Rule	Number
indebtedness / guarantee / relative's securities	> ₹5 lakh / > ₹1 lakh / > ₹1 lakh	s.447 term / public interest	6 months–10 years / ≥ 3 years
audit limit · fraud conviction bar	20 companies · 10 years	s.447 fine	≥ amount, ≤ 3 times
ADT-3 · fine	30 days · ₹50,000–₹2 lakh	fraud report to the Board	within 2 days
s.143(12) penalty (amended)	₹5 lakh listed / ₹1 lakh others	NCLT / NCLAT technical member	15 / 25 years
s.147: fine / wilful	₹25,000–₹5 lakh / ₹50,000–₹25 lakh	independent directors (listed)	one-third