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Q. 2 (a) (i) Strategic Risks

Strategic risks are risks that relate to the fundamental and key decisions that the directors take about the future of the organization

(ii) Operational Risks

Operational risks are the risk of loss from a failure of internal business and control process. It relate to matters that can go wrong on a day to day basis while the organization is carrying out its business.

(iii) Contractual Inadequacy Risks

Business may also face problems arising out of inadequately drafted or ambiguous contracts. Contracts may be difficult to enforce or leave loopholes that render the business liable to legal action.

(iv) Political Risks

Political risk is the risk that political action will affect the position and value of a company. It is connected with country risk, the risk associated with undertaking transaction with, or holding assets in, a particular country.

(v) Stakeholder Risks

A poor relationship with stakeholders is also a significant strategic risk because of the consequences of non-cooperation, for example investors not contributing new funds, suppliers not delivering on time, employees disrupting production and ultimately of course customers not buying goods and services.

(vi) Event Risks

The most important disruptions include failure of information technology or extreme weather, but operations may be delayed or prevented for other reasons as well. These include employee error, product problems, health and safety issues, losses of employees or suppliers, or legal action.

(b) (i) Interest Rate Risk: If a firm has a significant amount of variable (floating) rate debt, interest rate movements will give rise to uncertainty about the cost of servicing this debt.

(ii) Commodity Price Risk: Large or unexpected fluctuations in the price of crude oil can cause significant problems for business.

(iii) Physical Risk: Risk of goods being lost or stolen in transit, or the documents accompanying the goods going astray.

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(c) Interest Rate Risk:

Interest rate risk is the risk to the profitability or value of a company resulting from changes in interest rates.

Methods of reducing interest rate risk include:

- Netting – aggregating all positions, assets and liabilities, and hedging the net exposure
- Smoothing – maintaining a balance between fixed and floating rate borrowing
- Matching – matching assets and liabilities to have a common interest rate
- Pooling
- Forward rate agreements (FRAs)
- Interest rate futures
- Interest rate options or interest rate guarantees
- Interest rate swaps

Q. 3 (a) Form and Content of the Audit Engagement Letter

(i) The objective & scope of the audit of the financial statements.

(ii) The responsibilities of the auditor.

(iii) The responsibilities of management.

(iv) Identification of the applicable financial reporting framework for the preparation of the financial statements.

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

(vi) The form of any other communication of results of the audit engagement.

(vii) The fact that because of the inherent limitation of an audit and internal control, there is an unavoidable risk that some material misstatement may not be detected.

(viii) Arrangement regarding the planning and performance of the audit, including the composition of the audit team.

(ix) The expectation that management will provide written representations.

(x) The agreement of management to make available to the auditor draft financial statements and any accompanying other information in time to allow the auditor to complete the audit in accordance with the proposed timetable.

(xi) The agreement of the management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of auditor's report to the date financial statement are issued.

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(xii) The basis on which fees are computed and any billing arrangements.

(xiii) A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.

(xiv) Arrangement concerning the involvement of other auditors and experts in some aspects of the audit.

(xv) Arrangement concerning the involvement of internal auditors and other staff of the entity.

(xvi) Arrangement to be made with the predecessor auditor, if any, in the case of an initial audit.

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

(xviii) Any reference to any further agreements between the auditor and the entity.

(xix) Any obligation to provide audit working papers to third parties.

(b) Conditions That May Cast Doubt about Going Concern Assumption

(Any 7 points)

The following are examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption.

Financial:

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawal of financial support by creditors.
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.
- Inability to comply with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.

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Operating:

- Management intentions to liquidate the entity or to cease operations.
- Loss of key management without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labor difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

Other:

- Non-compliance with capital or other statutory requirements.
- Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
- Changes in law or regulation or government policy expected to adversely affect the entity.
- Uninsured or underinsured catastrophes when they occur.

Q. 4 (a) Records and Documents that the Auditor May Inspect During the Audit of Related Party Transactions:

During the audit, the auditor may inspect records or documents that may provide information about related party relationships and transactions, for example:

- Third-party confirmations obtained by the auditor (in addition to bank and legal confirmations).
- Entity income tax returns.
- Information supplied by the entity to regulatory authorities.
- Shareholder registers to identify the entity's principal shareholders.
- Statements of conflicts of interest from management and those charged with governance.
- Records of the entity's investments and those of its pension plans.
- Contracts and agreements with key management or those charged with governance.
- Significant contracts and agreements not in the entity's ordinary course of business.
- Specific invoices and correspondence from the entity's professional advisors.
- Life insurance policies acquired by the entity.
- Significant contracts re-negotiated by the entity during the period.

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- Internal auditors' reports.
- Documents associated with the entity's filings with a securities regulator (for example, prospectuses).

(b) (i) Anomaly:

A misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population.

(ii) Tolerable Misstatement:

A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

(iii) Statistical Sampling:

An approach to sampling that has the following characteristics:

- Random selection of the sample items; and
- The use of probability theory to evaluate sample results, including measurement of sampling risk.

Q. 5 (a) Control Procedures regarding Purchases and Sales:

(i) Un-authorized Purchases

1) Purchase requisitions should be approved by authorized personnel.
2) Limits of authority should be established for ordering of goods.
3) Pre-numbered purchase orders should be used for all purchase over a specified amount.

(ii) Mis-Appropriation for Inventories

1) Warehouse should be adequately secured.
2) Perpetual inventory records should be maintained independently of handling function.
3) Physical inventory should be regularly compared with book inventory and differences should be investigated.
4) Adequate control should be established for sale of scrap.!

(iii) Dispatched of Goods to a Bad Credit Risk

1) Orders should be accepted only from customers whose credit worthiness has been investigated.
2) Goods should be dispatched only against approved sales orders.
3) Credits limits should be established for all customers.

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(iv) Teeming & Lading

1) Statement of accounts should be sent on regular basis
2) Reconciliation of control and subsidiary ledger should be independently reviewed.
3) Posting to customer accounts should be independently checked.
4) The date when cash is received from customer and the date when cash is deposited in bank should be independently compared.

(b) Adequate Planning Benefits during the Audit of Financial Statements:

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

- Helping the auditor to devote appropriate attention to important areas of the audit.
- Helping the auditor identify and resolve potential problems on a timely basis.
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
- Facilitating the direction and supervision of engagement team members and the review of their work.
- Assisting, where applicable, in coordination of work done by auditors of components and experts.

Q. 6 (a) Powers and Duties of Cost Auditor:

The cost auditor has the same powers and duties as the financial auditor may have in terms of section 255, including the following:

(1) Every auditor of a company shall have a right of access at all times to the books, papers, accounts and vouchers of the company, whether kept at the registered office of the company or elsewhere, and shall be entitled to require from the company and the directors and other officers of the company such information and explanation as he thinks necessary for the performance of the duties of the auditors.

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(2) In the case of a company having a branch office outside Pakistan, it shall be sufficient if the auditor is allowed access to such copies of, and extracts from, the books and papers of the branch as have been transmitted to the principal office of the company in Pakistan.

(3) If any office of a Company refuses or fails, without lawful justification, the onus whereof shall lie on him, to allow any auditor access to any books and papers in his custody or power, or to give any such information possessed by him as and when required, or otherwise hinders, obstructs or delays an auditor in the performance of his duties or the exercise of his powers.

(b) Particular to be Included in Cost Audit Report to the Directors of the Company.

(i) Capacity
(ii) Cost accounting system
(iii) Production
(iv) Raw Material
(v) Wages and salaries
(vi) Stores and spare parts
(vii) Depreciation
(viii) Overheads
(ix) Royalty/technical aid payments
(x) Abnormal non-recurring features
(xi) Cost of production
(xii) Sales
(xiii) Profitability
(xiv) Cost auditors observation and conclusion
(xv) Reconciliation with financial account
(xvi) Cost statement
(xvii) Miscellaneous

Q. 7 (a) Reliance on the Work done by the Internal Auditors:

(1). Objectivity of Internal Audit Functions:

(i) The status of internal audit function within the entity and the effect such status has on the ability of the internal auditors to be objective.

(ii) Whether the internal function reports to those charged with governance or an officer with appropriate authority, and whether the internal auditors have direct access to those charged with governance.

(iii) Whether the internal auditors are free of any conflicting responsibilities.

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(iv) Whether those charged with governance oversee employment decisions related to the internal audit function.

(v) Whether there are any constraints or restriction placed on the internal audit function by management or those charged with governance.

(vi) Whether, and to what extent, management acts on the recommendations of the internal audit function, and how such action is evidenced.

(2). Technical Competence:

(i) Whether the internal auditors are members of relevant professional bodies.

(ii) Whether the internal auditors have adequate technical training and proficiency as internal auditors.

(iii) Whether there are established policies for hiring and training internal auditors.

(3). Due Professional Care:

(i) Whether activities of the internal audit function are properly planned, supervised, reviewed and documented.

(ii) The existence and adequacy of audit manuals or other similar documents, work programs and internal audit documentation.

(4). Communication:

(i) Meetings are held at appropriate intervals throughout the period;

(ii) The external auditor is advised of and has access to relevant internal audit reports and is informed of any significant matters that come to the attention of the internal auditors when such matters may affect the work of the external auditor; and

(iii) The external auditor informs the internal auditors of any significant matters that may affect the internal audit function.

(b) Audit Risks:

(i) It is a control risk. To mitigate that risk verify the bank reconciliation process with timing & interval.

(ii) It is a detection risk. To mitigate that risk ensure debtors confirmation independently.

(iii) It is inherent risks. To mitigate such risk always try to have upgrade product and technology with certain interval.

(iv) It is a control risk can be mitigated by having study of why staff is leaving and motivate the staff to stay. Segregation of duties is very important to mitigate the fraud.

(v) It is also a control risk. To mitigate such risk start immediately perpetual inventory system which reduces cost of inventory.!

THE END