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Q.2 (a) Approaches of Risk Identification:

The three (3) main approaches to risk identification are:

- **Exposure Analysis:**

  The identification of risks that could affect *assets*.

- **Environmental Analysis:**

  The identification of risks that could affect *operations*.

- **Threat Scenarios:**

  Specialized risk identification for *frauds and/or disasters*.

(b) Names of External Environment factors:

The organization exists in an external environment made up of many other factors, such as physical environment. The other factors are as follows:

- **Economic Environment:**

  Finances, interest rates, general economy.

- **Government Regulation:**

  Laws, policies and regulations – real or impending.

- **Competition:**

  Direct competitors, substitutions, indirect competitors.

- **Constituents/ Customers.**
- **Suppliers (including Unions).**
- **Technology.**

(c) (i) Risk:

A measure of *uncertainty*. In the business process, the uncertainty is about the achievement of *organizational objectives*. May involve *positive* or *negative consequences,* although most positive risks are known as *opportunities* and negative risks are called simply *risks*.

(ii) Risk Classification:

The categorization of risk, typically into *high, medium, low* and *intermediate* values.

(iii) Portfolio Risk:

In risk analysis, it is the risk that a particular *combination of projects, assets, units* or whatever is in the portfolio will fail to meet the overall objectives of the portfolio due to *poor balance of risks within the portfolio*.

Q.3 (a) (i) Internal Auditor Reports to Finance Director:

The internal auditor should report to *audit committee* to enhance its *independence*. Otherwise, he will always have fear of losing his job.

(ii) Same Individual is the CEO and Chairman:

Duties of Chairman and CEO should be *segregated* so that *no one individual has wide powers and authority* to run the business.

(iii) The Executive Board Annually Evaluates the Performance of the Chairman.

The performance should be evaluated by *non executive directors*. Evaluation of performance of Chairman by executive board *may not be free from bias*.

(b) Fraud and Fraudulent Financial Reporting:

- **Fraud:**

  An intentional act by one or more individuals among management, those charged with *governance, employees, or third parties*, involving the *use of deception* to obtain an *unjust or illegal advantage*.

- **Fraudulent Financial Reporting**

  Involves *intentional misstatement*, including *omissions of amounts or disclosures in financial statements, to deceive financial statement users*.

(c) Factors that may Affect the Identification of an Appropriate Benchmark in Determining the Materiality for the Financial Statements:

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance user may tend to focus on profit, revenue or net assets);
- The nature of the entity, where the entity is in its life cycle, and the industry and economic environment in which the entity operates;
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- The relative volatility of the benchmark.

Q.4 (a) Steps to be Taken by the Management for Cut-Off Procedures:

Cut-off procedures represent arrangements made for ensuring that at a particular point of time, example December 31, there will be agreement between the physical stock-in-trade and work-in-process and the figures actually shown in the accounts as obtained from the records of purchases, sales, debtors and creditors.

For operationalising cut-off procedures, the following steps be taken:

1. Stocks relating to outsiders and held on their behalf be excluded from the stocks of the enterprise.
2. Stocks owned by the enterprise, wherever situated, should be included in the closing inventory.
3. Movement of goods in and out at the closing date should be carefully examined.
4. Goods sold but not delivered on the financial closing date should be excluded from the inventory.
5. Goods bought but not received should not only be included in purchases but also in stock-in-transit.

(b) Procedure to be Adopted for Vouching Payment of Wages: *{Any eight (08)}*

The following steps should be taken for vouching the wages paid:

1. Casts and cross casts of the wages sheets or wages book should be checked and the amount should be traced into the cash book.
2. Calculations of the amounts should be checked. The extent of checking would depend upon the adequacy or otherwise of the system of internal check.
3. The basis of payments (daily rates, or hourly rates or piece-work rates) should be enquired into and it should be seen that it has been followed in practice.
4. Time-keeping records and/or piece-work records should also be checked with the wages sheets or wages book.
5. Payee's acknowledgements should be checked. In case of thumb impression, the auditor should ensure that they were authenticated. In case of money order remittances, M.O. (money order) acknowledgements should be checked. If the amount has been credited to wage earners' accounts in a bank, advices of the bank should be examined.
6. All unpaid amounts should be traced into unpaid wages register and subsequent payment out of them should be verified with the said register.
7. The total amount of wages payable should be checked with the amount of the cheque drawn.
8. In order to see that no dummy or ghost labour is included in the wages sheets/ book, the names of some of the workers as mentioned in the wages sheets/ book should be checked with the job cards, and gatekeeper's and the foreman's register.
9. The auditor should ensure that the wages sheets/ book has been properly signed by a responsible official. The part played by several persons in preparing or checking the wages sheets/ book should be noted on it and signed.
10. Allocation of wages paid should also be verified.
11. A test check on surprise basis to ensure the physical presence/ existence of the wage-earners is also suggested.

Q.5 (a) Basic Division of Duties in any Internal Control System:

The following duties should be performed by different persons:

- Initiation of transaction;
- Custody or handling of the related asset;
- Recording the transaction.

If these duties are segregated than no one person is in a position to execute a complete transaction and therefore collusion would be required for a fraud to be perpetrated.

(b) (i) Receipt of Goods:

All goods received should be *physically checked, counted or weighed* and a document called "*Goods Received Note*" *should be prepared and signed* by the store-keeper in token of having received. A copy thereof should be *sent to the accounts department*. All goods requiring *chemical analysis* should be analyzed by the *chemist or quality control department at the time of receipt of goods*.

(ii) Invoice:

The invoice should be internally checked before payment. The following work in this respect should be done:

(a) See that the date of invoice falls in the year under review.

(b) The quantity and description of goods should be checked with purchase order and goods received notes to ensure that all quantities ordered and invoiced have been received. Any discrepancies should be investigated.

(c) The rates should be verified with the purchased order and/or any contract.

(d) Extensions, casts and cross casts should be checked.

(e) A rubber stamp should be affixed indicating the checking work done on each invoice and should be signed by the staff member who performed that job.

(iii) Goods Returned:

All goods returned to suppliers should be recorded on goods returned note, a copy of which should be forwarded to accounts section. A credit note should be obtained from the supplier and amount adjusted in the books.

(c) Factors that may Affect the External Auditor's Determination:

Factors that may affect the external auditor's determination of whether the work of the internal auditors is likely to be adequate for the purposes of the audit include: ***{Any two (02) points in each factor}***

Objectivity:

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

- Whether the internal audit 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.
- Whether the internal auditors are free of any conflicting responsibilities.
- Whether those charged with governance oversee employment decisions related to the internal audit function.
- Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance.
- Whether, and to what extent, management acts on the recommendations of the internal audit function, and how such action is evidenced.

Technical Competence:

- Whether the internal auditors are members of relevant professional bodies.
- Whether the internal auditors have adequate technical training and proficiency as internal auditors.
- Whether there are established policies for hiring and training internal auditors.

Due Professional Care:

- Whether activities of the internal audit function are properly planned, supervised, reviewed and documented.
- The existence and adequacy of audit manuals or other similar documents, work programs and internal audit documentation.

Communication:

Communication between the external auditor and the internal auditors may be most effective when the internal auditors are free to communicate openly with the external auditors, and:

- Meetings are held at appropriate intervals throughout the period;
- 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
- The external auditor informs the internal auditors of any significant matters that may affect the internal audit function.

Q.6 (a) (i) Management: ***{Any three (03)}***

The following are the merits of cost audit for the management:

1. It discloses the errors and frauds and suggests the prevention.
2. It enables the management in reducing cost and maximising profit to satisfy the shareholders.
3. It provides a continuous check on all wastages and suggests the proper remedial action to control them.
4. It improves the cost accounting methods and provides better internal control to the management.

5. It leads the management to initiate action for economic and efficient usage of materials, labour and factory overhead.
6. It helps the management to operate budgetary control and standard costing successfully.
7. It helps the management to keep the records and information upto-date.

(ii) External Auditors:

The following are the merits of cost audit for the external auditors:

- It ensures the *correctness and adequacy* of the valuating of inventories. It discloses that all the transactions of the concern are *free from errors and frauds*.

(iii) Shareholders:

The following are the merits of cost audit for the shareholders:

- It provides information to the shareholders regarding the *efficiency* or otherwise *of management, proper utilisation of resources and productivity of prime cost*.

(b) (i) Production Capacity:

The cost auditor should check the production capacity of the plant. The main aim of checking of capacity is to examine the unutilised capacity so that the management can be suggested accordingly to make any improvement in increasing the capacity and efficiency of the organization. The cost auditor is required to keep into consideration the following points, while assessing the production capacity of an organization: ***{Any five (05)}***

1. The rated capacity of machines.
2. Normal machine hours after making allowance for holidays and maintenance period.
3. Machine history card.
4. Records relating to utilisation of machines.
5. The manufacturing process and documentation of completion of different stages of a unit.
6. The final stage after which any unit may be treated as fully completed in all respect.
7. Policies relating to maintenance of machines.
8. External factor affecting production demand and supply of the product.
9. Production budget.

(ii) Power and Fuel: *{Any five (05)}*

The cost auditor should check the following points with regards to power and fuel:

1. Total cost of power and fuel.
2. Percentage of allocation of total cost to different cost centres.
3. Whether power is internally produced.
4. Adequacy of system of allocation of cost of power and fuel.
5. Whether any residuary is used as fuel (in case of sugar industry).
6. Any leakage of power from the source of supply to the usage point.

THE END