

RISK MANAGEMENT AND AUDIT – SEMESTER-5

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Question No. 1

- (a) There may be so many risk factors in place during the phase of completion of CPEC, some of them are mentioned below other than business risk: **[Any ten (10)]**

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- 1- Country risk
- 2- Political instability risk/Political risk
- 3- International pressure
- 4- Risk of non-availability of skilled workers.
- 5- Market Risk.
- 6- Commodity Price Risk./Inflation Risk
- 7- Cash Management Risk.
- 8- Credit Risk.
- 9- Liquidity Risk
- 10- Currency Risk./Foreign Exchange Risk
- 11- Interest Rate Risk.
- 12- Gearing Risk./Borrowing/Lending Risk
- 13- Legal Risk
- 14- Regulatory /Compliance Risk
- 15- Technology Risk
- 16- Economic Risk
- 17- Environmental /Weather Risk/Hazard Risk

- (b) **Descriptions of Interest Rate Risks and Currency Risks:**

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Interest Rate Risks:

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

Future interest rates cannot be easily predicted. 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. Conversely, if a company uses a lot of fixed rate debt, it will lose out if interest rates begin to fall.

The exposure to interest rate risk can be reduced by hedging techniques similar to those used for the management of currency risk.

Currency Risks:

Currency risk is the possibility of loss or gain due to future changes in exchange rates.

When a firm trades with an overseas supplier or customer, and the invoice is in the overseas currency, it will expose itself to exchange rate or currency risk. The final amount payable/receivable in the home currency will be uncertain at the time of entering into the transaction and the exchange rates may change between the date of the transaction and the date of settlement. Investment in a foreign country or borrowing in a foreign currency will also carry this risk.

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(c) Methods of Reducing Interest Rate Risks and Currency Risks:

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Methods of reducing interest rate risk include:

- (i) Netting – aggregating in positions, assets and liabilities, and hedging the net exposure
- (ii) Smoothing – maintaining a balance between fixed and floating rate borrowing
- (iii) Matching – matching assets and liabilities to have a common interest rate
- (iv) Pooling
- (v) Forward rate agreements – Fixes interest rate on future borrowing
- (vi) Interest rate futures – Borrowers sell future and lenders buy futures
- (vii) Interest rate options or interest rate guarantees – Limited exposure to adverse movements and can take advantages of favourable movements
- (viii) Interest rate swaps – 2 parties exchange interest rate payments

Methods of reducing currency risk:

- (i) Forward Exchange Contracts
- (ii) Money Market hedging
- (iii) Currency futures
- (iv) Currency options
- (v) Currency swaps

Question No. 2**(a) ISA 265 – Communicating Deficiencies in Internal Control to Those Charged with Governance and Management: [Any six (06)]**

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Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process;
- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
- The interaction of the deficiency with other deficiencies in internal control.

(b) (i) Preconditions for an audit are as follows:

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- (a) An acceptable financial reporting framework has been used by the management in the preparation of the financial statements; and
- (b) The management and, where appropriate, those charged with governance agreed on the premise on which the audit is to be conducted.

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(ii) In order to establish whether the preconditions for an audit are present, we will:

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- (a) determine whether the financial reporting framework to be applied in the preparation of financial statements is acceptable;
- (b) obtain the agreement of management that it acknowledges and understands its responsibility:
- for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
 - for such internal control, as management determines, is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - to provide us with:
 - access to all information of which management is aware, that may be relevant to the preparation of the financial statements;
 - additional information that the auditor may request from management for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determine it necessary to obtain audit evidence.

(iii) If a precondition for an audit is not present, the matter would be discussed with the management. Unless required by law or regulation to do so, we will not accept the proposed audit engagement, if the pre-conditions are not met.

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However, if it is determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation, the audit engagement will be accepted only if the following conditions are met:

- (i) Management agrees to provide additional disclosures in the financial statements to avoid the financial statements being misleading;
- (ii) It is recognized in the terms of the audit engagement that:
- Our report on the financial statement will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures
 - Our opinion on the financial statements will not include such phrases as "present fairly, in all material respect," or "give a true and fair view" unless it is expressly required to be stated under the law or regulation.

If the above conditions are not present and still we are required by law or regulation to undertake the audit engagement, we shall:

- (i) evaluate the effect of the misleading nature of the financial statements on report; and
- (ii) Include appropriate reference to this matter in the terms of the audit engagement.

(c) (i) Identification of Fraud Risk Factors:

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The fact that fraud is usually concealed can make it very difficult to detect. Nevertheless, the auditor may identify events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud (fraud risk factors). In this scenario, the fraud risk factors may include:

- The need to meet expectations of third parties to obtain additional equity financing may create pressure to commit fraud;
- The granting of significant bonuses if unrealistic profit targets are met may create an incentive to commit fraud; and
- A control environment that is not effective may create an opportunity to commit fraud.

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(ii) Examples of Circumstances that Indicate the Possibility of Fraud:

The following are examples of circumstances that may indicate the possibility that the financial statements may contain a material misstatement resulting from fraud.

(1) Discrepancies in the accounting records, including: [Any two (2)]

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- Transactions that are not recorded in a complete or timely manner or improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorized balances or transactions.
- Last-minute adjustments that significantly affect financial results.
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Tips or complaints to the auditor about alleged fraud.

(2) Conflicting or missing evidence, including: [Any two (2)]

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- Missing documents.
- Documents that appear to have been altered.
- Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist.
- Significant unexplained items on reconciliation.
- Unusual balance sheet changes or changes in trends or important financial statement ratios or relationships - for example, receivables growing faster than revenues.
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures.
- Unusual discrepancies between the entity's records and confirmation replies.
- Large numbers of credit entries and other adjustments made to accounts receivable records.
- Unexplained or inadequately explained differences between the accounts receivable sub-ledger and the control account, or between the customer statements and the accounts receivable sub-ledger.
- Missing or non-existent cancelled checks in circumstances where cancelled checks are ordinarily returned to the entity with the bank statement. Missing inventory or physical assets of significant magnitude.
- Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies.
- Fewer responses to confirmations than anticipated or a greater number of responses than anticipated.
- Inability to produce evidence of key systems development and program change testing and implementation activities for current-year system changes and deployments.

(3) Problematic or unusual relationships between the auditor and management, including: [Any two (2)]

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- Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
- Undue time pressures imposed by management to resolve complex or contentious issues.

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- Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
- Unusual delays by the entity in providing requested information.
- Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques.
- Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.
- An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.
- An unwillingness to address identified deficiencies in internal control on a timely basis.

(iii) Procedure performed to address the Fraud Risk relating to Debtors:

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In order to address the fraud risk relating to debtors, the auditor shall initially perform the following procedures:

- (i) The auditor will discuss amongst the engagement team regarding the susceptibility of the client's financial statements to material misstatement due to fraud.
- (ii) The auditor then shall perform procedure to obtain an understanding of the client and its environment. According to ISA 315 this should include the following procedures:
 - (a) Enquiry of management regarding their assessment of fraud risk, the procedure they perform and whether they are aware of any actual or suspected instances of fraud.
 - (b) Enquiry of the internal audit functions to establish if they are aware of any actual or suspected instances of fraud.
 - (c) Enquiry of those charged with governance with regard to how they exercise oversight of management process for identifying the risk of fraud and whether they are aware of any actual or suspected fraud.
 - (d) Consideration of relationships identified during analytical procedures.
- (iii) In accordance with ISA 330, the auditor shall determine overall responses to address the risk of material misstatement due to fraud at financial statement level. This include:
 - Allocation of and supervision of team members to particular procedures.
 - evaluation of accounting polices

The auditor shall perform the following audit procedures when fraud is suspected or discovered

- (a) Review journal entries made to identify manipulation of figures recorded or unauthorized journal adjustments:
 - (i) Enquiry of those involved in financial reporting about unusual activity relating to adjustments.
 - (ii) Select journal entries and adjustments made at the end of the reporting period.
 - (iii) Consider the need to test journal entries throughout the period.
 - (iv) Design external confirmations not only to confirm outstanding amounts but also to confirm the details of the sales agreements including date, any rights of return and delivery terms.

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- (b) Review management estimates for evidence of bias:
- (i) Evaluate the reasonableness of judgments and whether they indicate any bias on behalf of management.
 - (ii) Perform a retrospective review of management judgments reflected in the prior year.
 - (iii) Review transactions outside the normal course of business, or transactions which appear unusual and assess whether they are indicative of fraudulent financial reporting.
 - (iv) Use unpredictable procedures to obtain evidence.

Question No. 3**(a) Substantive Procedures:**

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Trade Payables and Accruals:

- Calculate the trade payable days for Alliance Clubs Co. (ACC) and compare to prior years, investigate any significant difference, in particular any decrease for this year.
- Compare the total trade payables and list of accruals against prior year and investigate any significant differences.
- Discuss with management the process they have undertaken to quantify the understatement of trade payables due to the cut-off error and consider the materiality of the error.
- Discuss with management whether any correcting journal entry has been included for the understatement.
- Select a sample of purchase invoices received between the period of October 25, and the year end and follow them through to inclusion within accruals or as part of the trade payables journal adjustment.
- Review after date payments; if they relate to the current year, then follow through to the purchase ledger or accrual listing to ensure they are recorded in the correct period.
- Obtain supplier statements and reconcile these to the purchase ledger balances, and investigate any reconciling items.
- Select a sample of payable balances and perform a trade payables' circularisation, follow up any non-replies and any reconciling items between the balance confirmed and the trade payable's balance.
- Select a sample of goods received notes (GRN) before the year end and after the year end and follow through to inclusion in the correct period's payables balance, to ensure correct cut-off.

Depreciation:

- Review the reasonableness of the depreciation rates applied to the new leisure facilities and compare to industry averages.
- Review the capital expenditure budgets for the next few years to assess whether there are any plans to replace any of the new leisure equipment, as this would indicate that the useful life is less than 10 years.
- Review profits and losses on disposal of assets disposed of in the year, to assess the reasonableness of the deprecation policies.
- Select a sample of leisure equipment and recalculate the depreciation charge to ensure that the non-current asset register is correct.
- Perform a proof in total calculation for the depreciation charged on the equipment, discuss with management if significant fluctuations arise.
- Review the disclosure of the depreciation charges and policies in the draft financial statements.

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(b) Test of Control:

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Test of control refers to an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Example of tests of control over wages and salaries

- Inspect numerical sequence of clock cards/ timesheets; if any breaks in the sequence are noted, enquire of management as to missing payroll records.
- Review a sample of timesheets/ clock cards for evidence of authorisation of overtime by a responsible official.
- Observe whether there is adequate segregation of duties between human resources and payroll departments.

Question No. 4

- (a)** The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people.

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The control environment encompasses the following elements:

(i) Communication and Enforcement of Integrity and Ethical Values:

The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behavior is the product of the entity's ethical and behavioral standards, how they are communicated, and how they are reinforced in practice. The enforcement of integrity and ethical values includes, for example,

- 1- Management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts.
- 2- The communication of entity policies on integrity and ethical values may include the communication of behavioral standards to personnel through policy statements and codes of conduct and by example.

(ii) Commitment to Competence:

Competence is the knowledge and skills necessary to accomplish tasks that define the individual's job. Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.

(iii) Participation by Those Charged with Governance:

An entity's control consciousness is influenced significantly by those charged with governance. The importance of the responsibilities of those charged with governance is recognized in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle blower procedures and the process for reviewing the effectiveness of the entity's internal control.

(iv) Management's Philosophy and Operating Style:

Management's philosophy and operating style encompass a broad range of characteristics. For example,

Management's attitudes and actions toward financial reporting may manifest themselves through conservative or aggressive selection from available alternative accounting principles, or conscientiousness and conservatism with which accounting estimates are developed.

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(v) Organizational Structure:

The frame work, within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.

Establishing a relevant organizational structure includes considering key areas of authority and responsibility and appropriate lines of reporting. The appropriateness of an entity's organizational structure depends, in part, on its size and the nature of its activities.

(vi) Assignment of Authority and Responsibility:

Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorization hierarchies are established. The assignment of authority and responsibility may include

- 1- Policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties.
- 2- Policies and communications directed at ensuring that all personnel understand the entity's objectives, know how their individual actions interrelate and contribute to those objectives, and recognize how and for what they will be held accountable.

(vii) Human Resource Policies and Practices:

Human resource policies and practices often demonstrate important matters in relation to the control consciousness of an entity. For example,

- 1- Standards for recruiting the most qualified individuals - with emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behavior - demonstrate an entity's commitment to competent and trustworthy people.
- 2- Training policies that communicate prospective roles and responsibilities and include practices such as training schools and seminars illustrate expected levels of performance and behavior.
- 3- Promotions driven by periodic performance appraisals demonstrate the entity's commitment to the advancement of qualified personnel to higher levels of responsibility.

(b) (i) Materiality:

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"Materiality" is defined in the International Accounting Standards Board's "Framework for the Preparation and Presentation of Financial Statements" in the following terms:

Information is material if its omission or misstatement could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgements about materiality are made in the light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

In designing the audit plan, the auditor establishes an acceptable materiality level so as to detect quantitatively material misstatements. However, both the amount (quantity) and nature (quality) of misstatements need to be considered.

- (ii)** There is an inverse relationship between materiality and the level of audit risk, that is, the higher the materiality level, the lower the audit risk and vice versa. The auditor takes the inverse relationship between materiality and audit risk into account when determining the nature, timing and extent of audit procedures. For example, if, after planning for specific audit procedures, the auditor determines that the acceptable materiality level is lower, audit risk is increased. The auditor would compensate for this by either:

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- (i) Reducing the assessed risk of material misstatement, where this is possible, and supporting the reduced level by carrying out extended or additional tests of control; or
- (ii) Reducing detection risk by modifying the nature, timing and extent of planned substantive procedures.
- (iii)** Generally speaking, the materiality is considered on the basis of financial impact of any transaction, account balance or presentation or disclosure. Another aspect of the materiality may be the qualitative attributes of items under consideration. Based on both quantitative and qualitative aspects of a transaction, account balance or presentation and disclosure, the auditor shall decide whether such item is material or not. The publicity and advertisement expenses incurred on launching of the new products are considered to be material being a sizable and significant in monetary terms. Any misstatement in this area is expected to affect the rational decision making by the users on the basis of financial statements, therefore, these shall be considered material for the year under audit: 02
- (iv)** As explained above audit risk can be broken down into risk of material misstatement in financial statements such as inherent and control and the auditor's part of the risk such as the detection risk. The auditor shall assess the risk of material misstatements in financial statements due to inherent and control risks and accordingly determine his part of the risk to manage the overall audit risk. Considering the inherent and control risk factors present in the given situation the significant audit risks areas for the year ending June 30, 2010 may include the following: 02
1. The export sales affecting the valuation, completeness and recoverability aspects of the revenue.
 2. Advertisement and publicity expense on new products may also be considered a significant risk area for the current year due to its monetary size and considering the fact that it is type of non-recurring item and controls may not be effective to handle any misstatement in this area.
 3. The arrangements with the supplier of newly introduced products may also be considered a significant factor and may affect various areas such as imports, local sales and after sale services. Accordingly, this can impact the revenue and cost of sales for the year under audit.

Question No. 5

- (a) Safeguards to be adopted to address the conflict of interest of auditing both Generation (Pvt.) Limited and Millennium (Pvt.) Limited:** 05
- Both Generation and Millennium should be notified that Bukhari & Co. would be acting as auditors for each company and if necessary consent obtained.
 - Advising one or both clients to seek additional independent advice.
 - The use of separate engagement teams, with different engagement partners and team members; once an employee has worked on one audit such as Generation Company then they would be prevented from being on the audit of Millennium Company for a period of time. This separation of teams is known as building a 'Chinese wall'.
 - Procedures to prevent access to information, for example, strict physical separation of both teams, confidential and secure data filing.
 - Clear guidelines for members of each engagement team on issues of security and confidentiality. These guidelines could be included within the audit engagement letter.

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- Potentially the use of confidentiality agreements signed by employees and partners of the firm.
- Regular monitoring of the application of the above safeguards by a senior individual in Bukhari & Company not involved in either audit.

(b) Provisions to be Reviewed as per the Code of Corporate Governance, 2012 Related to the Statement of Compliance: 05**(i) Number of Directorship in Companies:**

No person shall be elected or nominated as a director / Chairperson of more than seven listed companies simultaneously.

(ii) Casual Vacancy:

Any casual vacancy in the Board of Directors of a listed company shall be filled up by the directors at the earliest but not later than 90 days thereof.

(iii) Composition of Audit Committee:

The Board of Directors of every listed company shall establish an Audit Committee, of not less than three members including the chairman of the committee, who shall preferably be an independent director, the committee shall comprise of non-executive directors, the majority of whom shall preferably be independent directors. The board shall satisfy itself such that at least one member of the Audit committee has relevant financial skills / expertise and experience.

(iv) Composition of HR and Remuneration Committee:

The HR and remuneration committee shall consist of not less than three members comprising of non-executive directors and preferably including at least one independent director. The Board may, in addition include CEO as a member of the committee. The chairman of the committee shall preferably be an independent director.

(v) Closed Period:

Each listed company shall determine a closed period prior to the announcement of interim/ final results and any business decision, which may materially affect the market price of its shares. No director, CEO or executive shall directly or indirectly deal in the shares of the listed company in any manner during the closed period.

The closed period shall start from the day when any document/statement, which forms the basis of price sensitive information, is sent to the Board of Directors and terminate after the information is made public.

(c) Definitions of Emphasis of Matter paragraph and Other Matter Paragraph: 03**Emphasis of Matter paragraph:**

A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Other Matter Paragraph:

A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

(d) In our opinion and to the best of our information and according to the explanation given to us, the financial statements conform with approved accounting standards as applicable in Pakistan, and give the information required by the Companies Ordinance 1984, in the manner so required and respectively give a true and fair view of the state of the company's affairs as at _____ and of the profit/loss, the comprehensive income (if applicable), the changes in equity (if applicable) and its cash flows (if applicable) for the year ended. 03

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- (e) **Identification and Explanation of Amendments to be made in the Extracts of the Draft Audit Report:** 06

Extract 1:

'Our responsibility is to express an opinion on all pages of the financial statements.'

This is incomplete as the auditor is required to list the components of the financial statements which have been audited, being: statement of financial position, statement of profit or loss (income statement), statement of cash flows, summary of significant accounting policies and other explanatory information detailed in the notes to the financial statements.

'We conducted our audit in accordance with most of the International Standards on Auditing (ISAs).' An auditor is required to perform their audit in accordance with all ISAs and cannot just choose to apply some. They must state that they follow all ISAs.

Extract 2:

'Obtain maximum assurance as to whether the financial statements are free from all misstatements.' The auditor is not able to obtain maximum assurance and they cannot confirm that the financial statements contain no errors. This is because they do not test every transaction or balance as it is not practical. They only test a sample of transactions and may only consider material balances. Hence auditors give reasonable assurance that financial statements are free from material misstatements.

Extract 3:

'We have a responsibility to prevent fraud and error.' This is not correct as it is in fact management's and not the auditor's responsibility to prevent and detect fraud and error. The auditor only has a responsibility to detect material misstatements whether caused by fraud or error.

'We prepare the financial statements.' Again this is a responsibility of management, as they prepare the financial statements. The auditor provides an opinion on the truth and fairness of the financial statements.

Question No. 6

- (a) **Purposes of Cost Audit:** 03

- (1) To verify the accuracy of Cost Accounting data.
- (2) To ensure that the books of cost accounts have been properly maintained according to the principles and practice of costing employed in the industry concerned.
- (3) To verify that the cost of production reports are properly drawn up as per the records and that they show a true and fair views of the cost of production.
- (4) To detect any error or fraud that might have been committed deliberately or otherwise.
- (5) To verify that the cost accounting procedures prescribed by the management have been adhered to or not.
- (6) To ascertain the abnormal losses or gains together with their causes.
- (7) To check and critically evaluate unit cost of the finished goods.

- (b) **Cost Auditors' Report:** 06

- (1) Every company shall, in addition to the records statements specified in the order or the Corporate Law Authority/SECP issued under clause sub-section (1) of Section 230 of the Companies Ordinance, 1984, prepare:

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- (a) a statement of production capacity of the plant, in terms of machine hours and production units, the actual utilization of the capacity and the reasons of difference between the two; and
- (b) a statements of stock-in-trade of the company as at the end of financial year in terms of quantity and cost thereof distinguishing between:
- (i) stock of raw material and components;
 - (ii) stock of work in process;
 - (iii) stock of finished products; and
 - (iv) other stock.
- (2) The statement specified in clauses (a) and (b) of sub-rule (1) shall be signed by the chief executive and chief accountant of the company.
- (3) The cost auditor shall make out a report within sixty days of his appointment to the directors in the specified form set out along with a statement of capacity utilization and stock-in-trade as specified in clauses (a) and (b) of sub-rule (1) in the specified form set out and simultaneously shall submit two copies to the Corporate Law Authority/ SECP and the registrar concerned.
- (4) The company shall, within thirty days from the date of receipt of copy of the report, furnish the Corporate Law Authority/SECP with full information and explanation on every reservation or qualification contained in such report.

(c) Information to be Collected for Cost Audit:

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Cost Accounting System:

Cost accounting system is based on the need of an organisation. This is prepared after the careful study of all business activities of the organisation. Cost auditor should keep into consideration the following aspects while assessing suitability and weakness of the cost accounting system:

- (i) Manufacturing process of the product.
- (ii) Internal control system.
- (iii) Cost ascertainment of joint products and basis of apportionment.
- (iv) Standard costing system.
- (v) Budgetary control system.
- (vi) Prime cost.

Factory Overheads:

The cost auditor should check the following items of factory overheads:

- (i) Elements of the factory overhead such as indirect materials, direct labour, power and fuel depreciation, etc.
- (ii) Basis of allocation of service overheads to cost centres.
- (iii) Standard overhead rate.
- (iv) Factory overhead control accounts.
- (v) Factory overhead applied account.
- (vi) Accountability of overheads applied and actual overheads.
- (vii) Overhead variances.
- (viii) Under or over applied overheads.

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