

COST AUDITORS' REPORT TO THE DIRECTORS

We BDO EBRAHIM & CO., Chartered Accountants having been appointed to conduct an audit of cost accounts of **FAUJI CEMENT COMPANY LIMITED**, have examined the books of account and the statements prescribed under clause (e) of subsection (1) of section 230 of the Companies Ordinance, 1984 and other relevant record for the year ended on June 30, 2011 and report that:

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of this audit.

In our opinion:

- (a) proper cost accounting records as required by clause (e) of sub-section (1) of section 230 of the Companies Ordinance, 1984 (XLVII of 1984), and as required by these rules, have been kept by the company;
- (b) proper returns, statements and schedules for the purpose of audit of cost accounts have been received from branches not visited by us; and
- (c) the said books and records give the information required by the rules in the manner so required; and

in our opinion and, subject to the best of our information:

- (a) the annexed statement of capacity utilization and stock-in-trade are in agreement with the books of account of the company and exhibit true and fair view of the company's affairs; and
- (b) cost accounting records have been properly kept so as to give a true and fair view of the cost of production, processing, manufacturing and marketing of the product of the company, namely Ordinary Portland Cement.

The matter contained in the ANNEX forms part of this report.

ISLAMABAD

DATED: *Sept: 30, 2011*

Abdul Qadeer
CHARTERED ACCOUNTANTS
Engagement partner: Abdul Qadeer

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FAUJI CEMENT COMPANY LIMITED
STATEMENT OF PRODUCTION CAPACITY
AS AT JUNE 30, 2011

	2011		2010	
	(Tonnes)	(Tonnes)	(Tonnes)	(Tonnes)
Production Capacity				
Installed capacity	1,110,000	1,165,500	1,110,000	1,165,500
Actual utilisation	1,118,070	1,101,677	1,065,788	1,128,258
Percentage of utilisation	100.73%	94.52%	96.02%	96.80%
	(Kiln)	(Cement Mill)	(Kiln)	(Cement Mill)
Machine Hours				
Standard hours	7,200	7,200	7,200	7,200
Actual hours	7,410	6,186	6,950	6,169
Percentage of utilisation	102.92%	85.91%	96.53%	85.68%

Sahib Khan

CHIEF EXECUTIVE

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CHIEF FINANCIAL OFFICER

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 COST AUDITORS
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**COST AUDITORS' REPORT
TO THE DIRECTORS OF THE COMPANY
FOR THE YEAR ENDED JUNE 30, 2011**

1. Capacity:

(a) Licensed, installed and utilized capacity:

	<u>Clinker (Tonnes)</u>	<u>Cement (Tonnes)</u>
Licensed and Installed	1,110,000	1,165,500
Utilized capacity	1,118,070	1,101,677
Percentage utilized	100.73%	94.52%

(b) The company is not engaged in activity other than manufacturing and sale of Ordinary Portland Cement.

2. Cost Accounting System:

The company uses process costing system in order to determine the cost of product. The production process has been divided into distinct cost centres (processes and services centres). Expenses directly identifiable to a cost centre are charged directly while unidentifiable expenses are apportioned to all other cost centres. The apportion is based on the proportionate role that each cost centre plays in the complete process of manufacturing and packing of cement. A study was conducted in the year 2005 in which percentage were agreed and subsequently approved by the Board of Directors for charging indirect cost. Further the company reviews these percentages every year in the light of additions to fixed assets and apportioned basis of depreciation and insurance are changed accordingly.

3. Production:

		<u>2011</u>	<u>2010</u>
(a) Cement	(in tonnes)	1,101,677	1,128,258
Clinker	(in tonnes)	1,118,070	1,065,788
(b) Percentage utilization			
- Cement		94.52%	96.80%
- Clinker		100.73%	96.02%

4. Raw Materials:

(a) Consumption of major raw materials in terms of quantity and value:

Raw Materials	2011		2010	
	Quantity Consumed (Tonnes)	Amount (Rupees)	Quantity Consumed (Tonnes)	Amount (Rupees)
Limestone	1,532,694	171,390,636	1,488,529	157,442,575
Clay	189,587	13,103,752	154,689	10,248,351
Laterite	61,195	56,975,645	49,087	34,883,369
Gypsum	57,106	37,783,955	52,568	31,315,109
	<u>1,840,582</u>	<u>279,253,988</u>	<u>1,744,873</u>	<u>233,889,404</u>

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The purchase price of laterite and gypsum is inclusive of a large component of carriage, which is as follows:

Carriage charges on materials	2011	2010
	(Rupees)	(Rupees)
Laterite	79,596,022	23,718,260
Gypsum	61,144,709	36,357,400
	<u>140,740,731</u>	<u>60,075,660</u>

(b) Consumption of major materials per unit of production compared with standard consumption:

Raw Materials	Actual Consumption Per Unit (Tonnes per tonne of clinker/cement)			Standard Consumption
	2011	2010	2009	
Limestone (per metric tonne of clinker)	1.37	1.40	1.36	1.26
Clay (per metric tonne of clinker)	0.17	0.15	0.18	0.32
Laterite (per metric tonne of clinker)	0.05	0.05	0.06	0.04
Gypsum (per metric tonne of cement)	0.05	0.05	0.07	0.05
	<u>1.64</u>	<u>1.65</u>	<u>1.67</u>	<u>1.67</u>

(c) Explanation of variances

The small variances from standard requirement are due to the fact that the raw material i.e. Lime stone, clay, and laterite vary in their chemical compositions. The chemical contents keep on changing which is a natural phenomenon. While calculating the consumption ratio of limestone, the gypsum mixed with the limestone in the stock hall of 555 M Tonnes (2010: 1,191 M Tonnes, 2009: 1,320 M Tonnes) has been taken into consideration.

(d) Accounting System for Raw Materials

Receipt of materials is recorded in receiving report (RR) after inspection by the store department. All expenses incurred up to the receipt of material are included in the cost of material. Closing inventory is valued on weighted averages basis.

5. Wages and Salaries:

(a) Wages and salaries paid to different categories of employees during the year 2010-11 are as follows:

	2011	2010
	(Rupees)	(Rupees)
i. Direct labour cost on production	263,367,885	224,948,559
ii. Employees cost on administration	76,259,095	58,358,011
iii. Employees cost on selling and distribution	33,059,763	26,868,411
iv. Bonus to workers and employees	63,591,847	-
Total employees cost of (i) to (iii)	<u>372,686,743</u>	<u>310,174,981</u>
Total wages and salaries	<u>436,278,590</u>	<u>310,174,981</u>

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(b) Salary and perquisites of directors and chief executive are as under:

	<u>2011</u> (Rupees)	<u>2010</u> (Rupees)
Managerial remuneration	15,259,519	3,931,800
Company's contribution to provident fund	2,485,965	223,300
Compensated absences	2,929,658	872,550
Utilities and upkeep	792,512	1,245,750
	<u>21,467,654</u>	<u>6,273,400</u>
Number of persons	2	1
(c) Total man-days of direct labour for the year:	<u>2011</u>	<u>2010</u>
Available (days)	59,100	53,700
Actually worked (days)	55,864	51,984
% age	95%	97%
(d) Average number of workers including contracted labour during the year.	197	179
(e) Direct labour cost per unit of output of the product	<u>2011</u>	<u>2010</u>
Direct labour cost on production (including bonus) (Rupees)	308,169,175	224,948,559
Production of cement (Tonnes)	1,101,677	1,128,258
Total labour cost per unit of output (Rupees)	396.01	274.91
Direct labour cost per unit of output (Rupees)	279.73	199.38

(f) Variances:

The variance in per unit cost is due to increase in direct labour cost as a result of annual increments and bonus during the year.

(g) Incentive Scheme:

The company has not declared any incentives scheme during the year.

6. Stores and Spare Parts:

(a) Expenditure per unit of output on stores and spare parts:

	<u>2011</u>	<u>2010</u>
Expenditure (Rupees)	25,985,735	19,404,464
Production of cement (Tonnes)	1,101,677	1,128,258
Stores and spares per unit of production (Rupees)	23.59	17.20

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(b) System of Stores Accounting

All items of stores and spares are recorded in stores ledgers and are being accounted for on perpetual inventory system. The items are valued on moving average method through a computerised system.

(c) Proportion which have not moved for over twenty four months:

	2011	2010	2009
Total stores inventory	514,805,204	437,391,995	347,965,628
Slow moving stores	17,599,591	13,897,057	7,558,979
% age	3.42%	3.18%	2.17%

According to management those items are not technically obsolete, and can be utilised in plant's normal course of operation during its useful life. Accordingly, no provision for obsolescence has been considered necessary by the management.

7. Depreciation:

(a) Method of depreciation

The company is using straight line method of depreciation.

(b) Basis of allocation of depreciation on common assets

The depreciation has been charged to different departments as follows:

Departments	2011 Ratios	2010 Ratios	2009 Ratios
Crusher	7%	7%	7%
Stock/hall stacker	7%	7%	7%
Raw mill	17%	17%	17%
Kiln	39%	39%	39%
Cement mill	19%	19%	19%
Packing plant	5%	5%	5%
Compressed air	3%	3%	3%
Power plant	3%	3%	3%
	100%	100%	100%

(c) Basis of charging depreciation to the products

As the company is only producing cement, any depreciation charged to Cost of Sales forms part of the cost of cement.

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8. Overheads:

(a) Overheads and break up of items specified

	2011 (Rupees)	2010 (Rupees)	2009 (Rupees)
i. Factory Overheads			
Repair & maintenance	140,189,863	90,047,824	82,395,744
Insurance	23,115,163	15,412,203	16,194,017
Furnace oil/diesel/coal	1,929,374,706	1,337,948,184	1,773,555,946
Stores & spares	25,985,735	19,404,464	17,923,423
Power/gas	709,137,963	692,495,636	604,701,123
Depreciation	366,508,679	297,791,558	294,040,690
Technical fee and assistance	1,693,054	4,042,056	1,509,146
Other overheads	31,730,020	26,320,403	21,622,297
	3,227,735,183	2,483,462,328	2,811,942,386
ii. Administration Overheads			
Rent, rates and taxes	5,277,414	7,428,431	6,837,379
Traveling, and entertainment	4,896,538	4,962,959	3,235,904
Legal and professional	3,158,687	4,003,052	3,170,740
Printing and stationery	3,051,781	2,885,335	2,972,828
Insurance	495,664	636,003	737,542
Repairs and maintenance	1,993,924	594,299	586,821
Auditor's remuneration	975,000	975,000	660,000
Depreciation	7,360,955	10,510,409	9,495,367
Communication and establishment	8,582,100	6,796,616	5,590,695
Donation	17,678,343	1,880,000	5,205,980
Vehicle running and maintenance expenses	6,218,727	5,434,720	3,761,064
	59,689,133	46,106,824	42,254,320
iii. Selling and Distribution Overheads			
Traveling and entertainment	13,953,105	2,350,324	702,927
Vehicle running and maintenance expenses	1,975,648	2,042,003	1,864,284
Rent, rates and taxes	3,465,554	3,013,037	1,630,182
Repairs and maintenance	227,915	318,186	214,554
Printing and stationery	1,191,659	978,573	751,861
Depreciation	5,669,914	6,230,961	5,145,476
Communication and establishment	4,687,496	2,840,593	3,199,845
Advertisement and sales promotion expenses	3,918,752	3,049,437	2,430,335
Insurance	173,970	511,767	378,655
Export freight and other charges	-	1,101,412	8,758,074
(Reversal of)/provision for bad debts	-	(1,567,120)	-
	35,264,013	20,869,173	25,076,193
iv. Financial Charges			
Fee and charges on loans	-	500,000	500,000
Interest/markup on long-term finances	-	13,388,837	82,672,325
Bank charges and commission	5,734,798	5,407,561	4,979,530
Markup on short term borrowings	97,127,753	20,182,139	53,266,854
Markup on WPPF	64,234	922,497	328,267
Guarantee commission	995,676	804,798	673,116
	103,922,461	41,205,832	142,420,092
GRAND TOTAL	3,426,610,790	2,591,644,157	3,021,692,991

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(b) Reason for variances

- (i) Factory overheads have increased due to increase in prices of fuel resulting in increase in fuel cost and repair and maintenance cost .
- (ii) The administrative expense increase mainly due to payment of donation to flood affectees.
- (iii) Selling and distribution expenses have increased mainly due to increase in traveling and entertainment expenses.
- (iv) The increase in financial charges as compared to last year is due to interest on short term borrowing.

(c) Basis of allocation of overheads to departments

Factory overheads directly identifiable have been charged directly to the respective department, while remaining overheads have been apportioned on the following ratios to the various departments.

<u>Departments</u>	<u>2011</u> <u>(Ratio)</u>	<u>2010</u> <u>(Ratio)</u>	<u>2009</u> <u>(Ratio)</u>
Crusher	7%	7%	7%
Stock/hall stacker	3%	3%	3%
Raw mill	17%	17%	17%
Kiln	40%	40%	40%
Cement mill	20%	20%	20%
Packing plant	10%	10%	10%
Compressed air	2%	2%	2%
Power plant	1%	1%	1%
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

The apportionment is based on the proportioned role that each department plays in the complete process of manufacturing and packing of cement. These basis have been calculated keeping in view the financial aspect and the production aspect of the process carried out in each department.

(d) Cost of packing

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Number of bags consumed	21,268,763	21,810,483	22,460,120
Cost of bags consumed (rupees)	356,181,943	320,124,268	345,147,874
Sale of cement (tonnes)	1,056,284	1,068,513	1,114,430
Cost per metric tonne of cement (rupees per tonne)	337.2	299.6	309.7

Explanation of variance:

The variance is due to increase in prices of packing material.

9. Royalty and technical fee

2011		2010	
Amount (Rupees)	Rupees per Metric tonne of cement produced	Amount (Rupees)	Rupees per Metric tonne of cement produced

Royalty paid

Limestone	29,887,500	27.13	27,691,320	24.54
Clay	1,946,730	1.77	1,509,110	1.34
	31,834,230	28.90	29,200,430	25.88

2011		2010	
Amount Rupees	Cost per metric tonne (Rs)	Amount Rupees	Cost per metric tonne (Rs)

Technical fee paid

	1,693,054	1.54	4,042,056	3.58
	1,693,054	1.54	4,042,056	3.58

It represents the inspection fee paid to foreign consultants for the inspection of Kiln and Power plant (2010:Kiln).

10. Abnormal and non-recurring features:

- i. The Company has not observed any abnormal features e.g. strikes, lock-outs, major breakdown in the plant etc, significantly affecting the production during the year.
- ii. There were no abnormal expenses incurred during the year, that have been charged to the products.

11. Cost of Production:

	2011 Rupees	2010 Rupees
Cost per metric tonne of clinker	2,939.50	2,321.43
Cost per metric tonne of unpacked cement	3,213.35	2,599.73
Cost per metric tonne of packed cement	3,621.93	2,954.25

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12. Sales:

(a) Following are the statistics of the sales:

	2011		2010	
	Amount Rupees	Quantity Metric Tonne	Amount Rupees	Quantity Metric Tonne
Sales	5,788,301,272	1,084,558	4,902,395,840	1,119,576
Less:				
Government levies	(1,045,708,366)	-	(1,093,940,833)	-
Net Sales Realization	4,742,592,906	1,084,558	3,808,455,007	1,119,576
Average sales realization per metric tonne of cement	4,373		3,402	

The company sold 1,084,558 metric tonnes (2010 :1,119,576 metric tonnes) of Cement.

(b) Exports

The company exported 455,173 metric tonnes (2010: 332,931 metric tonnes) of cement.

	2011		2010	
	Amount Rupees	Quantity Metric Tonne	Amount Rupees	Quantity Metric Tonne
Export Sales	1,924,069,617	455,173	1,205,518,350	332,931
Less:				
Government levies	(5,562,637)		(3,477,169)	
Net Sales Realization	1,918,506,980	455,173	1,202,041,181	332,931
Average sales realization per metric tonne of cement	4,214.90		3,610.48	
Cost per metric ton of cement	(3,621.93)		(2,954.25)	
Profit per metric tonne of cement	592.97		656.23	

Explanation of variance

The variance is due to increase in the cost of sales and comparatively less increase in sale price of cement exported.

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13. Profitability:

The company is involved in the production and sales of Ordinary Portland Cement on which it earned profit as follows:

	2011		2010	
	Amount Rupees	Per unit (M Tonnes)	Amount Rupees	Per unit (M Tonnes)
Net sales	4,742,592,906	4,372.84	3,808,455,007	3,401.69
Less:				
Cost of sales	(3,919,540,601)	(3,613.95)	(3,292,870,474)	(2,941.18)
Gross profit	823,052,305	758.88	515,584,533	460.52
Less:				
Operating expenses	(259,031,612)	(238.84)	(176,687,834)	(157.82)
Operating profit/loss	564,020,693	520.05	338,896,699	302.70
Less:				
Financial charges	(103,922,461)	(95.82)	(41,205,832)	(36.80)
Add:				
Other income	28,052,743	25.87	27,219,735	24.31
Net profit as per cost accounts	488,150,975	450.09	324,910,602	290.21
Difference in inventories	2	0.00	-	-
Net profit as per financial accounts	488,150,977	450.09	324,910,602	290.21

14. Observations and conclusions:

Matters which appear clearly wrong in principle:

There is nothing to report on matters which appear clearly wrong in principle.

Cases where the company's funds have been used in an inefficient manner:

No cases were found where company's funds have been used in an inefficient manner.

Factors which could have been controlled but not being controlled:

No instances were observed where factors which could have been controlled, but were not done resulting in increase in the cost of production.

i. The adequacy or otherwise of budgetary control system:

The company has maintained a budgetary control system. Budgeting has been done on incremental basis. The planned level of activity has been considered for making operational budgets, significant variances were observed in some major cost components like salaries and wages, fuel, power and other variable expenses due to increase in input prices.

ii. The scope and performance of internal audit:

The company has an internal audit department. The department is headed by a qualified Chartered accountant, reporting directly to the Audit Committee.

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Improvement in performance:

i. Enhancement in installed capacity

The Company is in the process of commissioning of its new line of 7200 tonnes of clinker per day. Trial run production of new line was started in June 2011 after which the expected installed capacity of clinker and cement will be 10,900 and 11,445 tonnes per day respectively.

ii. Components on areas offering scope for:

I. Cost reduction

- (a). In order to reduce cost of production, the company is presently using Coal, Refused Derived Fuel (RDF) and Tyres as fuel in kiln instead of furnace oil.
- (b). The company is using limestone dust to decrease cost of production.

II. Energy conservancy

The heat consumption of the plant installed is 770 Kcal / kg of clinker which is equivalent to about 80 Kgs Furnace oil per M Tonne of clinker.

iii. State of technology, whether modern or obsolete

The cement plant was manufactured by F.L.Smith & Co, A/S (F.L.Smith) of Denmark. It has a maximum capacity of 3700 M Tonnes per day (TDP) of clinker and corresponding quantity of ordinary Portland cement (Gray cement as per Pakistan and British standard specifications).

iv. Plant whether new or second hand when installed.

The plant was new when installed.

15. Reconciliation with financial accounts

The reconciliation of cost statements with financial statements is annexed as Annexure 'X'.

16. Cost Statements

The cost statements of the production departments have been ANNEXED to the report.

The first two annexures have not been prepared as the company has outsourced the process of quarrying and transportation.

17. Miscellaneous

Comparisons of all figures and cost and production have been made with previous year.

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