National Diploma in Business L5

ASSESSMENT TASKS

Unit	1875	Version	5	Title	Assist the conduct of internal audit	L	5	C	4

NOTE: USE SEPARATE SHEETS FOR YOUR ANSWERS.

Task 1

Using the Case Study on the succeeding page, do the following :

1.1.1 Develop methodologies with the aim of establishing the integrity of financial records

1.1.2 Explain how the methodologies developed be implemented. (E1-PC 1.1)

1.2 Identify the errors and irregularities in the recording, classification, and summarising of financial transaction made by three executives in Pifco-Zen Chen Company Limited. (E1-PC 1.2)

1.3 Recommend a corrective action with regards to the errors and irregularities found in the financial transactions of Pifco-Zen Chen Company Limited. (E1-PC 1.3)

Task 2

2.1 Record in dollar terms and review the operating efficiencies of Pifco-Zen Chen Company Limited. (E2 –PC 2.1)

2.2 From the end balaces shown from the balance sheet and additional transactions stated in the preceeding paragraph, determine if organizational financial policies and procedures of Pifco-Zen Chen Company is observed. (E2-PC 2.2)

2.3 Make a report which identify the strengths and weaknesses of the company and include recommendation for improvement. (E2-PC 2.3)

CASE STUDY

PIFCO-ZEN CHEN COMPANY

Three Executives of a well-known multi-national company decided to form a new company, named New Star Company Limited in 2011. These three executives were becoming close to their retirement age. Pifco-Zen Chen Company Limited, the company that they worked for had been in business for the last 80 years. It was their previous employer's policy to retire the executives with a "golden hand-shake" worth approximately US$120,000 each. The three executives occupied the following position with Pifco-Zen Chen Company Limited, (1) Finance Manager – Mr. Zu Chang, (2) Sales & Marketing Manager, Mr. Lim Lam, and (3) Risk Management Manager, Mr. Shu Ching. In their previous position with Pifco-Zen Chen Company Limited, they were regarded as the most respected executives because the company made significant progress in terms of organic growth and diversification. The Chairman of the Board of Directors, Dr. Wing Wan used to call them "the three wise men". Pifco-Zen Chen Company Limited main business activities were the manufacturing of "twisties" and acted as wholesale distributor of a special drink called "Wysalt". The drink is full of calcium and protein and it is very popular in the South East Asia. Each year's Annual General Meeting of Pifco-Zen Chen Company Limited's gross income and net profit before taxation increased by 10%, while its main competitor's performance was declining at an alarming rate. Chairman Wan always wanted to find out what is the main reason driving its company's operational success. In a nutshell, Chairman Wan always believed that the financial result was "too good to be true" because whenever he has a chance to play golf with one of the Chairman of his competitor company, he was told that life as the head of a corporate is becoming unbearable due to competition and increased in the cost of living. Still, Mr. Wan kept quiet while congratulating his three wise men for a fantastic job each year. Even the external Auditors could not believe the significant progress, which the company used to, when the three wise men were working for Pifco-Zen Chen Company Limited. The auditors knowing too well the performance of the company before the departure of Mr. Chang, Mr. Lam, and Mr. Ching cautioned the Chairman that it would be a great loss for the company to loose three key executives in one go. In view of the continued pressure and perplexities of the situation, one afternoon, Chairman of Pifco-Zen Chen Company Limited, Dr. Wan called a special Board of Directors meeting to address his concern regarding the retirement of Mr. Chang, Mr. Lam, and Mr. Ching. One of the vocal directors. who did not get along very well with these three managers, said "it does not matter if all of the three men were to leave the company today because they are not indispensable people". He went on to argue further that "we can replace them easily because there are other professionals looking for work".

According to the employment contract of the three wise men, they were paid a basic salary plus they also benefited with a 2% commission on the net profit of the company each year after the accounts have been finalized by the external auditors. The Internal Auditor, Miss Wen always queried this employment terms that it favors mostly these three managers at the detriment of the other hard-working employees. One day in a management meeting, Miss Wen expressed her frustration of the favorable treatment of the three managers because she felt that they are working very close and perhaps, manipulating the figures so that they can benefit a hefty remuneration every year. Chairman Wan felt every uneasy during this meeting and closed the meeting earlier than expected. After the meeting, Miss Wen wrote a memo to the Chairman of the Board of Directors to complain that the external auditors come on the premises of the company for a very short time to perform the audit. They do not carry out an efficient audit and the Pifco-Zen Chen Company Limited runs the risk of facing a corporate collapse, when those three managers had left.

In the abridged version of the financial statement of Pifco-Zen Chen Company Limited, the following item appears at the end of the financial year 1975.

		US$ (miilion)
Net Fixed Assets		**45**
Investment in Subsidiaries		**30**
	US$ (miilion)	
Current Assets		
Stocks	**125**	
Debtors	**90**	
Prepaid Expenses	**40**	
Bank Deposits (7 Day Call Account)	**60**	
Cash at Banks	**30**	
Petty Cash	**1**	
	346	
Less: Current Liabilities		
Creditors	**45**	
Accrued Expenses	**30**	
Short-Term Debt	**55**	
Overdraft Balance	**75**	

	205		
Net Current Assets/(Liabilities)	**141**		
Total Net Assets			**216**
Financed by:			
Long-term Debts			**80**
Capital		**90**	
Accumulated Profit until 1975		**46**	
		136	
			216

In the financial statement there is an amount of US$ 25 million worth of over-valued stocks, which has been in the accounts for the last 5 years. No provision has been made in the Debtors Account for non-performing account worth US$9 million. Current operating expenditure to the value of US$ 7 million has been accounted as "prepaid expenditure". The bank reconciliation has not been done properly for the last 3 years, and the external auditors have accepted the Finance Manager's figure of US$ 30 million. It appears that there are 10 cheques valued to US$3 million has been deposited in the accounts, and have been returned by the banks because the customers did not have funds. There has need no adjustment made subsequently to correct the balances at banks. The exact figure for the Short-Term Debts should be US$ 65 million and not US$ 55 million as disclosed. There is a mistake in the disclosure of Overdraft Facility; the figure should appear as US$ 85 million and not US$75 million. In addition, the Sales & Marketing Manager has entered into a financial contract for one of the raw material suppliers to supply equipment to the value of US$15 million to increase production of twisties and this contract does not reflect in the statement of accounts. The external auditor stated that since there is only a commercial contract and the official invoice has not been received by the company, then there is no point to account for this transaction. A review of the quarterly report issued by the Risk Manager does not indicate any abnormality in the financial statement from a risk management perspective. Instead, the Risk Manager would normally end his report with the words "I foresee that the company is operating in a very sound and successful manner. The Board of Directors should be proud of such achievement". The Sales & Marketing Manager would give the indication that the company is progressing very well and eventually, it should be able to launch a "bid" to takeover one of its competitive rivals. The Finance Manager would normally end his reports with such phrases such as" good performance", "we are on the right track" "the Board of Directors should feel proud of the company's financial performance".