

- there is no requirement for a customer to apply for credit before making purchase from Margins (Pty) Ltd; (1½)
  - credit terms and limits are not in place for new or existing creditors; and (1½)
  - there is no up to date record of the state of a debtor's account (masterfile updated monthly). (1½)
- 1.3 As there is no check on whether an order is from "an approved customer", orders could be received from fictitious entities. The sale is processed and the "fictitious entity" is added to the debtors' masterfile. (As the system is currently, an individual posing as an entity could submit an order containing false contact details, and instead of having the goods delivered, could simply collect the goods from dispatch). (1½)

## **Recommendations:**

### **Credit management/sales authorization**

1. The responsibility for credit management should be taken over from Grace Face (the bookkeeper) by Peter Polar himself, assisted by Polly Nglanya who should take over the duties of credit controller. (1½)
2. Existing debtors on the debtors' masterfile should be required to complete a credit application form (1½)
  - Polly Nglanya and Peter Polar should follow up on the information provided, and taking into account the existing debtors history with Margins (Pty) Ltd, decide upon suitable terms (e.g. 60 days) and limits (e.g. R5000) for each debtor. (1½)
  - Each debtor should be notified of the new terms and any existing debtor who is not considered to be credit worthy, should be followed up and notified that credit will no longer be extended. (1½)
3. Where the order is received from a customer who does have an account, the credit application policy must be carried out, including the allocation of terms and limits being approved by Polly Nglanya and Peter Polar. This must be done before the customer's first order is processed. (1½)
4. A masterfile amendment form signed by Polly Nglanya and Peter Polar should be compiled and sent to Grace Face to add the debtor to the debtors' masterfile(1½)
  - Peter Polar should regularly check the log of masterfile amendments to ensure that no unapproved customers are added to the debtors' masterfile. (1½)
5. Grace Face should invoice the customers on a daily basis and update the debtors' masterfile (this will require that she update the cash receipts journal and debtors' masterfile for payments received from debtors) (1½)
  - On a daily basis she should check the numerical sequence of the delivery notes received from the driver and dispatch and follow up on any missing numbers. (1½)
  - If possible, a second employee should confirm that the invoices have been correctly compiled and accurately calculated(1½)

## Weakness 2

### Receiving Customer Orders/Sales Authorisation

1. No isolation of responsibility for receiving orders and no formal document on which to record the order. (1½)

#### Explanation:

- 1.1 Orders may be lost because they are "informally" taken at a number of sources (whichever employee receives the call) on non-sequenced documents. A lost order results in a lost sale. (1½)
- 1.2 As there is no formal, well designed document on which to record the order, incorrect and incomplete order details may be "jotted" down, resulting in orders which can't be processed, incorrect goods being dispatched, etc. (1½)
2. No sales authorization takes place. (1½)
3. The same order may be processed twice (duplicated) (1½)

#### Explanation:

- 3.1 Ben Chetti does not appear to check whether phone orders and mailed orders are the same order. (1½)
4. There is no follow up in the order department to establish whether all orders taken have been processed and invoiced. (1½)

#### Explanation:

- 4.1 Once the single copy picking slip is sent to the warehouse (and the message slips/customer orders thrown away) there is no record of the order being placed, which makes it impossible to follow up queries or reconcile orders received to orders processed. (1½)

### Recommendations:

### Receiving Customer Orders/Sales Authorisation

1. All phone orders should be directed to Ben Chetti only, and orders through the post should continue to be routed to him. (1½)
2. All orders should be recorded by Ben Chetti on pre-printed, sequenced 3 copy internal sales orders (ISO). The ISO should be designed to facilitate accuracy of recording with pre-designated spaces for:
  - details of customer i.e. name, address etc. (1½)
  - account number (1½)
  - customer Order reference (1½)
  - description, prices and quantity of goods ordered (1½)
  - date of order. (1½)
  - authorisation. (1½)
  - comments. (1½)and the second copy of the ISO should be pre-printed (or stamped) "PICKING SLIP".(1½)

3. On receiving a phone order, Ben Chetti should enquire whether the customer has an account number which he should check against a list of approved customers (debtors). (1½)
4. If the customer does not have an account number, the caller should be referred to Polly Nglanya, the accountant/credit controller. The same procedure should apply to orders received through the post from non-account holders. (Credit management procedures will then be put in place.) (1½)
5. If the customer has a valid account number, Ben Chetti should
  - 5.1 obtain all the necessary details (including a customer reference number) as indicated on the ISO. (1½)
  - 5.2 read back the details to the customer for confirmation before ending the phone call. (1½)
6. An ISO should also be made out for all orders received through the post; Ben Chetti should
  - 6.1 by reference to the customer order reference etc., check that the order is not a duplicate of a phone order. (1½)
  - 6.2 follow up with the customer on any missing details. (1½)
  - 6.3 cross reference and attach the customer's written order to the ISO. (The phone message slip could also be attached to its ISO.) (1½)
7. All ISOs should be signed by Ben Chetti. (1½)
8. At regular intervals Ben Chetti should send a batch of sequenced ISOs to Polly Nglanya. On receipt of the batch, Polly Nglanya should:
  - 8.1 sequence check the ISOs. (1½)
  - 8.2 establish whether the debtor has sufficient available credit and is up to date with payments (creditworthy) (1½)
  - 8.3 authorise (sign) the ISOs which satisfy the creditworthiness tests. (1½)
9. The batch of ISOs should be returned to Ben Chetti. If a customer is deemed not creditworthy, the ISO must be retained on a pending file by Ben Chetti. (1½)
  - 9.1 the customer should be notified by Ben Chetti that the order will be cancelled or can be filled once the customer gets the account up to date. (1½)
10. A fast copy of the ISO should be retained in numerical sequence by Ben Chetti and the third copy sent to the accounts department to be matched at a later stage to other documentation supporting the transaction. (1½)
11. On a weekly basis, Ben Chetti should cross-reference his sequenced file of ISOs to the file of picking slips/delivery notes in the warehouse and invoices in accounting and should follow up on ISOs that cannot be matched, as these probably represent ISOs which have not been "picked" and invoiced. (1½)

### **Weakness 3**

#### **Processing of orders/dispatch**

1. The transfer of the picking slips to the warehouse is inadequate. (1½)

**Explanation:**

- 1.1 The picking slips are placed in a wire basket in the warehouse and could easily be lost (1½)
2. There is no supporting document kept to support the picking of goods. (1½)

**Explanation:**

- 2.1 The picking slip is thrown away, which means that there is no way of
- following up any order or picking queries (1½)
  - matching picking slips to subsequent dispatches/invoices. It is also not possible to reconcile orders received with picking slips, or vice versa, as the original customer order/message slip is also thrown away. (1½)

3. The pickers are not accountable for their actions. (1½)

**Explanation:**

- 3.1 The pickers do not record any problems with picking or acknowledge their performance. Picking irregularities/errors cannot be isolated to the responsible picker. (1½)
4. A poor division of duties between the pickers and the dispatch clerk; facilitates theft by the dispatch clerk. This is compounded by the lack of controls over the transfer of goods from the warehouse to the dispatch. (1½)

**Explanation:**

- 4.1 The basic division of duties between "picking" and "dispatch" is present but not implemented properly because the pickers do not note any shortages on the picking slip, the dispatch clerk could easily remove (steal) an item that has been picked from the box and mark it as a "not in stock" or "incomplete order". (1½)
- 4.2 The fact that the dispatch clerk makes out the delivery note worsens the situation because he can hide his theft by ensuring that the delivery note agrees with what is actually delivered, and an explanation of any short deliveries is provided to the customer. (1½)
- 4.3 Because the source documentation is thrown away, it is virtually impossible to identify or follow up on this type of theft. (1½)
5. There is no timeous notification of stock shortages given to the customer and no system of recording "back orders" and notifying Margins (Pty) Ltd purchase (buying) department of the need to purchase the inventory items to fill back orders. (1½)

**Explanation:**

- 5.1 The first that the customer knows that the order cannot be filled is when he receives the short delivered goods. (1½)
- 5.2 No documentation to notify Ben Chetti and the buying department is created at any time. This is going to result in customer dissatisfaction and lost sales. (1½)

**Recommendations:****Processing of orders/dispatch**

1. Controls over the transfer of picking slips should be improved by
- 1.1 introducing a simple register into which Ben Chetti enters the sequential numbers of a batch of picking slips being transferred to the warehouse. (1½)

- 1.2 the register, plus the picking slips should be taken to Rajen Dukes, the stores foreman, who should carry out a sequence test and document count and sign the register to acknowledge the receipt. (Could be done by Sarif Keito.) (1½)
  2. Rajen Dukes should distribute the picking slips to the pickers. (1½)
  3. The pickers should pick the goods, initialing (ticking) each item picked on the picking slip as they go
    - 3.1 all shortages (items which cannot be supplied) should be marked clearly on the picking slip (1½)
    - 3.2 the picker must sign the picking slip. (1½)
  4. The goods picked and the corresponding picking slip should be placed in the box in a demarcated area. (1½)
  - 4.1 Sarif Keito should be transferred and appointed as a warehouse clerk. He should:
    - check the goods in the box to the picking slip (1½)
    - prepare 3 part delivery note from the picking slip (cross-referencing the documents) (1½)
    - sign the delivery note. (1½)
  5. At the same time Sarif Keito should prepare a 3 part back order note for stock shortages. The back order notes should be cross-referenced and distributed as follows:
    - 5.1 Copy to Ben Chetti to enable him to contact the customer (1½)
    - 5.2 Copy to the company's buying department (purchasing) (1½)
    - 5.3 Filed numerically in the warehouse. (1½)
  6. Once these controls over the picked goods have been successfully completed, Sarif Keito should transfer the boxes to the dispatch area with the picking slip and delivery notes (1½)
    - 6.1 The dispatch clerk should agree the goods (description and quality) he is receiving to the delivery note and picking slip and sign the delivery note to acknowledge the transfer of the goods to his custody. (1½)
    - 6.2 Sarif Keito should retain one copy of the delivery note and attach the picking slip to it
      - the delivery note and picking slip should be filed in the warehouse in numerical order (1½)
      - the remaining two delivery notes will be sent with the goods as is currently done. (1½)
    - 6.3 He should seal and address the box as is currently done. (1½)
  7. On a frequent and regular basis, both Ben Chetti and Sarif Keito should follow up on the status of back-orders using their respective filed copies (1½)
    - 7.1 When goods become available, Ben Chetti should confirm with the customer that the goods are still required and if so, initiate the sale by making out an ISO. (1½)
  8. The existing system of preparing a list of deliveries and having the driver acknowledge receipt of the boxes to be delivered is satisfactory, but the practicality of a gate control/security check of goods leaving the premises could be introduced. (1½)
- (1½ for each valid comment to a maximum of 40 marks)**

**Comments:**

This question asked you to identify and explain weaknesses in the revenue and receipts cycle. You were also required to provide recommendations or improvements to the company's control activities/ internal controls in order to address the weakness identified.

The solution covers all weaknesses identified for each of the relevant phases (e.g. Processing of orders) in the revenue and receipts cycle and then presents the recommendations for improvements. Take note that the weaknesses and recommendations are presented separately under headings for the relevant phase. Also that marks were awarded for answering the required by identifying and then explaining the weakness.

You would also have noticed that the weaknesses identified, are not just a "memory dump" from the theory, but theory applied to this specific scenario. Thus the application of the theory to a scenario is a skill that you must acquire as it will be of benefit to you in your later studies in auditing.

The explanation part of this question ensures that you understand the theory and are able to apply it in a practical situation.

## Topic 5 Acquisitions and Payments Cycle

### Feedback on supplementary Do questions on topic 5

#### QUESTION 10.2 IN GRADED QUESTIONS

10 marks

**Reference:** Jackson & Stent (2014: 11/3 - 11/5 and 11/9 - 11/13)

1. Receiving (1)
2. Payment and Recording (1)
3. Ordering (1)
4. Ordering or Receiving (1)
5. Receiving (1)
6. Recording of Acquisitions (1)
7. Recording of Acquisitions (1)
8. Payment and Recording (1)
9. Recording of Acquisitions (1)
10. Receiving (1)

(1 for each valid answer to a maximum of 10 marks)

**Comments:**

To answer the question you should know the functions and control measures that normally takes place in the acquisitions and payments cycle as described in your text book Jackson & Stent (2014: 11/3-11/5; 11/9-11/13).

**QUESTION 10.6 IN GRADED QUESTIONS****36 marks**

**Reference:** Jackson & Stent (2014: 8/7 – 8/41 & 11/9 – 11/13)

1. Yes, I do agree with this statement. (1½)

Reason: If control activities (and the control environment) are not sound, employees have a number of opportunities to perpetrate fraud. In particular, the payments side of the cycle is designed to facilitate the outflow of cash from the business and if controls over the outflow are not extremely tight, misappropriation of cash becomes easy e.g. raising of and paying fictitious creditors, payment of the same account twice (colluding with suppliers). (1½)

The other side of the cycle deals with the purchasing of goods and again if controls over the receiving of goods are not sound, the company could end up paying for goods they never received e.g. the receiving clerks sign for goods which are never delivered and, working in collusion with the supplier, sell the goods for their own account. (1½)

Similarly if the buying (ordering) of goods is not subjected to sound internal control, buyers could be purchasing from their own (private) business enterprises at inflated prices, or obtaining kickbacks for placing orders with certain suppliers. (1½)

2. Mary Merson should:

- match the suppliers invoice to the corresponding goods received note, supplier's delivery note and the purchase order to confirm that the invoice represents the quantity and description of goods ordered and received. (1½)
- confirm by reference to the approved supplier list that the purchase is from an approved supplier. (1½)
- confirm by reference to supplier price lists, the order form (or other form of agreement), that the correct prices and discount have been charged and granted. (1½)
- by reference to the purchase order/list of accounts, determine/confirm the account to which the items purchased must be allocated and enter the account number on the invoice. (1½)
- reperform all casts, extentions and calculations (e.g. VAT) on the invoice. (1½)
- inspect each of the supporting documents for the signature of the person responsible for compiling the document e.g. buyer, receiving clerk. (1½)
- sign the invoice to acknowledge that she has performed the necessary control procedures (use of a "check box" stamp is recommended). (1½)

3.1 What this means is that the acquisitions and payments software has been designed in modules (each module being a function in the application) and that employees can be given access to only those modules which they need to **perform their function**. (1½)

- Mary Merson is only required to enter purchase details. She therefore needs access only to the “enter invoices/create purchase journal” module. She does not require access to, for example, the creditors’ masterfile amendments module or the “generate purchase order” module. (1½)

3.2 As explained, the division of duties is achieved by limiting access to the modules which the staff member needs to perform. This can be achieved by:

- restricting access to employees by the use of user ID’s and passwords and user profiles. (1½)
- only employees who need access to the system are given a user identification. This must be keyed in by the user to **identify** himself to the system. The system will not recognize an invalid user ID. (1½)
- the user must then **authenticate** himself by entering a password which the computer will recognize or reject. (1½)
- the password is linked to the employee’s **user profile** and if the password is valid the computer will “refer” to the user profile. The user profile **authorizes** exactly privileges the user has with regard to the application/modules/data the user has been granted. (1½)
- the user profile will also stipulate the level of access which the employee has been granted e.g. read only access, write access. (1½)
- levels of access are granted on a least privilege/need to know basis. (1½)
- in this manner, division of duties (and isolation of responsibilities) can be achieved but it is very important that employees keep their passwords confidential. (1½)
- Although the current trend is to restrict access through use of **user** identification etc, division of duties can also be achieved by:
  - restricting access to specific **terminals** i.e. authorised terminals are defined to the system in such a way that they serve only a particular functional area. (1½)
  - restricting the extent of access e.g. read only, which is granted to a user. The user profile would define the applications, modules within the application, and the extent of access which the user needs to perform his/her function. (1½)

4. I conclude the controls are sound because the following procedures are in place:

- All cheques must be signed by two approved cheque signatories who are senior members of staff (usually Tim Cruise and Sterling Dorlock). There are three approved signatories, two of whom must sign. (1½)
- Before signing the cheque, the signatories agree details on the cheque i.e. date, payee, amount to the supporting documentation including the creditors reconciliation, to confirm the validity and accuracy of the payment. (1½)

- Both cheque signatories “cancel” the supporting documentation to ensure that it cannot be presented again. (Note: this could be done by signing and dating or by using a date/cancelled stamp.) (1½)
  - Signatories inspect the cheque carefully to ensure that it is made out in a manner which minimizes the chance of the cheque being subsequently altered. (1½)
    - The full name of the payee is inserted (1½)
    - All cheques are crossed “not transferable” and (1½)
    - Gaps are not left on the cheque into which additional detail can be added to change the amount or payee. (1½)
  - Good controls are maintained over cheque books, both those in use and those unissued.
    - Cheque books and cheques are issued in numerical sequence and kept by Tim Cruise when not in use(1½)
    - Unissued cheque books are kept locked away and receipts and issues thereof are recorded in a register. (1½)
5. The controls to ensure that masterfile amendments are valid, accurate and complete are as follows:
- All amendments to the masterfile are entered on a preprinted, sequenced masterfile amendment form (MAF). (1½)
  - All MAF's are supported by authorised documentation which is cross-referenced to the MAF e.g. (1½)
    - For adding an approved supplier, the supplier evaluation documentation signed by, say, the factory manager and Sterling Dorlock(1½)
    - For changing banking details an instruction signed by two senior members of the suppliers staff. Officestuff (Pty) Ltd could also request a letter from the supplier's bank confirming the change. (1½)
  - All MAFs are approved by two senior employees. (1½)
  - Access to the write facility for the masterfile amendment module of the acquisition and payments software, is restricted to Sterling Dorlock's terminal (possibly) and to Sterling Dorlock (or other specific staff member) by terminal identification, user ID and passwords. (1½)
  - All masterfile amendments are automatically logged (on sequenced logs) by the computer and no write access is granted to the log (read access will also be restricted to Tim Cruise and Sterling Dorlock). (1½)
  - On a regular basis (and before any month end payments are made) Tim Cruise reviews the logs to ensure that logged amendments are supported by suitable evidence i.e. supporting documentation and a signed MAF. Any unsupported or out of the ordinary amendments are followed up. (1½)
  - Unused MAFs are subject to strict stationery controls. (1½)
  - The software contains programme checks to assist in the accurate capture of data e.g.
    - alphanumerics, verification checks(1½)
    - screen prompts, screen dialogue, minimum entry.(1½)
  - When reviewing the logs (see 5.5 above) Tim Cruise checks the accuracy of the amendment against the source documentation, paying particular attention to fields such as the creditors bank account number. (1½)

- The software performs an automatic sequence check on the number of the MAF entered (e.g. retains the number of the last MAF entered and anticipates the next number.) (1½)
  - Tim Cruise sequence tests the logs themselves as well as the MAF numbers on the log to identify any gaps/cancelled MAFs. (1½)
6. The advantages of paying creditors by EFT are:
- All forms of cheque fraud are eliminated. (Note: this does not mean all forms of payment fraud are eliminated. EFT controls must be very strong.) (1½)
  - It is far more efficient to pay by EFT than by cheque both from an accuracy and time perspective. It is time consuming and easy to make mistakes when writing out numerous cheques. Suppliers receive payment far more promptly. (1½)
  - Creditors prefer it as the consequences of a bounced cheque (cheque not honoured) can be long and drawn out. (The cheque deposited, stopped, sent back to the payer etc, which all takes time. With an EFT payment if there are insufficient funds, the payer is notified immediately. Similarly, the payment delaying tactic of "the cheque is in the post" cannot be effectively used.) (1½)

**(1½ for each valid comment to a maximum of 36 marks)**

**Comments:**

This question covers various areas of the acquisitions and payments cycle. It is a good question to test your knowledge and understanding of this cycle. Link the questions that the senior has asked you to the relevant notes you prepared before your meeting with him.

## Topic 6 Inventory and Production Cycle

### Feedback on supplementary Do questions on topic 6

#### QUESTION 11.5 IN GRADED QUESTIONS

**20 marks**

**References:** Jackson & Stent (2014: 8/7 – 8/41 & 12/6 – 12/10)

	<b>General/application control</b>	<b>Objective of the control</b>
1.	General control (1½)	implemented to assist in preventing theft of inventory. (1½)
2.	Application control (1½)	implemented to provide a division of duties between custody of the inventory and record keeping for inventory. (1½)
3.	Application control (1½)	implemented to detect discrepancies between actual and physical inventory to assist in the prevention of theft of inventory and to promote accuracy in inventory record keeping. (1½)
4.	Application control (1½)	implemented to isolate the responsibility for the inventory once it has been transferred from the custody of the goods receiving bay personnel to the warehouse personnel. (1½)

	<b>General/application control</b>	<b>Objective of the control</b>
5.	General control (1½)	implemented to improve the control environment at Soundwaves (Pty) Ltd. Reflects management's commitment to the competence of staff and a positive and pro-active philosophy and operating style. (1½)
6.	General control (1½)	this is an action/policy implemented to assist in protecting the company's inventory from theft/deterioration etc, and to protect the company from loss from being underinsured should inventory be stolen/damaged etc. This policy may also be regarded as part of the risk assessment process. (1½)
7.	General control (1½)	implemented to enhance the control environment by the enforcement of integrity and ethical values. (1½)
8.	Application control (1½)	implemented to prevent unauthorised amendments to the inventory records being made (primarily) to conceal theft of inventory. (1½)

**(1½ for each valid comment to a maximum of 20 marks)**

**Comments:**

You need to understand the difference between a general control and an application control. You will then be able to identify the objective of the control easier as well.

**QUESTION NUMBER 11.8 (b) IN GRADED QUESTIONS**

**20 marks**

**References:** Jackson & Stent (2014: 5/7 – 5/17 & 12/6 – 12/10)

**Weakness 1**

There is a lack of suitable documentation to initiate production i.e. no "production order", "job card" or similar document. (1½)

**Recommendation:**

- 1.1 Pre-printed, sequenced multi-part production orders should be introduced. (1½)
- 1.2 Once sales/marketing have notified the production manager of what is required, he should compile and sign a production order for **each** technician to complete a specific job, e.g. manufacture 25 surveillance cameras. (1½)
- 1.3 The production order should list every component required to construct the item to be manufactured. (1½)
- 1.4 The production order should be distributed as follows
  - copy 1 – to the technician (1½)
  - copy 2 – to the component warehouse (1½)
  - copy 3 – to foreman/production office (1½)
  - (a fourth copy could be sent to the finished goods store). (1½)

**Weakness 2**

There are inadequate custody controls over component inventory, e.g. technicians enter the warehouse and select the items they require. The responsibility for custody of inventory is not isolated to a warehousing section; this increases the risk of all kinds of inventory losses. (1½)

**Recommendation:**

- 2.1 A component warehouse store man should be appointed. (1½)
- 2.2 Technicians and other employees should not be given access to the component store, and physical access controls should be introduced as necessary. (1½)

### **Weakness 3**

- 3.1 No isolation of responsibility for inventory movement. There is no documentation to control the requisitioning or issue of components. (1½)
- 3.2 There is no documentation to control the transfer of completed units to the finished goods store. (1½)

### **Recommendation:**

- 3.1 When the technician requires components he should complete and sign a two-part, pre-printed, sequenced component requisition. (1½)
- 3.2 This document should be cross-referenced to the production order, for which the components are required. (1½)
- 3.3 The technician should detail the components required as per the production order and sign the requisition. (1½)
- 3.4 On receipt of the requisition, the component warehouse store man should:
  - confirm, by reference to his copy of the production order that the components requisitioned are included on the production order (valid). (1½)
  - make out and sign a two-part, pre-printed, sequenced component issue note detailing what is being issued (quantity and description) and cross-reference it to the component requisition. (1½)
- 3.5 On taking the components, the technician should check what he is accepting and sign the component issue note to acknowledge receipt thereof. (1½)
- 3.6 Component requisition and component issue notes should be filed together by numerical sequence (issue note). (1½)
- 3.7 On completion of a batch of units, the technician should complete and sign a two-part "finished goods transfer form", a pre-printed sequenced document, detailing the quantity and description of items completed and cross-referencing it to the relevant production order. (1½)
- 3.8 Both copies of the transfer document should accompany the goods to the finished goods warehouse where the warehouse clerk should
  - check what is being received against the transfer document and (1½)
  - sign both copies (1½)

### **Weakness 4**

No perpetual inventory records for either components or finished goods are kept. This weakens control over inventory. (1½)

### **Recommendation:**

- 4.1 A perpetual inventory system should be introduced. It should be kept up to date by recording movement of both components and finished goods from the documents introduced into the system as above (as well as purchase and sale documentation). (1½)

- 4.2 Regular cycle courts should be conducted and discrepancies followed up timeously. (1½)
- 4.3 The perpetual inventory records should be written up by the accounting department, or someone independent of the custody of inventory. (1½)

**(1½ for each valid comment to a maximum of 20 marks)**

**Comments:**

This question asked you to identify the weaknesses in those aspects of the production cycle and for each weakness make suitable recommendations for improvement. Take note of the layout of the solution as the recommendations follow directly after the weakness is described. Also the required made it clear that you do not have to concern yourself with the costing of manufactured items. Please do not waste time by dealing with this issue as it will waste time and not earn you marks.

## Topic 7 Payroll and Personnel Cycle

### Feedback on supplementary Do questions on topic 7

#### QUESTION 9.1 IN GRADED QUESTIONS

**22 marks**

**Reference:** Jackson & Stent (2014: 13/9 – 13/13)

	<b>Function</b>	<b>Risks</b>
1.	<p><b>Personnel</b></p> <p>1.1 Assisting with all personnel matters e.g. counselling, training and wage negotiation. (1½)</p> <p>1.2 Acting as an independent keeper of records pertaining to personnel. (1½)</p> <p>1.3 Facilitating the lawful recruitment and dismissal of personnel. (1½)</p>	<p>1.1 Engaging unsuitable staff, e.g. underqualified, not competent or unethical. (1½)</p> <p>1.2 Failing to comply with legislation e.g. illegal dismissal of workers. (1½)</p> <p>1.3 Failing to prevent unauthorised changes to employee records such as fictitious additions, changes to salary grades, etc (1½)</p>
2.	<p><b>Timekeeping</b></p> <p>2.1 Creating an accurate record of the hours for which employees must be remunerated, both normal and overtime hours. (1½)</p> <p>2.2 Calculating total hours worked or the week. (1½)</p>	<p>2.1 Failing to detect the recording of invalid hours (which will subsequently lead to the company paying employees for hours not worked) e.g.</p> <ul style="list-style-type: none"> <li>• card being clocked for a fictitious employee (1½)</li> <li>• employee clocking or “swiping” another employee’s clockcard or magnetic identification tag when that employee is absent (1½)</li> </ul> <p>2.2 Miscalculating normal hours and overtime hours (including the split between the two). (1½)</p>

Function	Risks
<b>3. Payroll preparation</b> <ul style="list-style-type: none"> <li>3.1 Calculating amounts payable in respect of genuine hours (gross). (1½)</li> <li>3.2 Determining deductions from gross pay. (1½)</li> <li>3.3 Creating the payroll reflecting net pay. (1½)</li> </ul>	<ul style="list-style-type: none"> <li>3.1 Addition of fictitious employees to the payroll. (1½)</li> <li>3.2 Use of incorrect/unauthorised payrates, hours or deduction tables which will result in the incorrect amount being paid. (1½)</li> <li>3.3 Cast and calculation errors. (1½)</li> </ul>
<b>4. Payment preparation and payment</b> <ul style="list-style-type: none"> <li>4.1 Place cash in the pay-packet and provide a record of how amount is made up. (1½)</li> <li>4.2 Paying out of wages <ul style="list-style-type: none"> <li>• Transfer wages to employees(1½)</li> <li>• Obtaining evidence that wages have been received. (1½)</li> </ul> </li> <li>4.3 Initiate control over unclaimed wages. (1½)</li> </ul>	<ul style="list-style-type: none"> <li>4.1 Errors or theft of cash during drawing of cash, making up of pay-packets and at the pay-out. (1½)</li> <li>4.2 Misappropriation of unclaimed wages. (1½)</li> </ul>
<b>5. Deductions: payment and recording</b> <ul style="list-style-type: none"> <li>5.1 Record amounts owed to other bodies in respect of amounts deducted e.g. PAYE, and (1½)</li> <li>5.2 Completion of supporting documentation (return) and payment of these liabilities to the relevant authorities timeously. (1½)</li> </ul>	<ul style="list-style-type: none"> <li>5.1 Incurring penalties for the non-payment, late payment or underpayment of amounts owed. (1½)</li> <li>5.2 Criminal/civil charges due to non-payment. (1½)</li> <li>5.3 Inaccurate amounts paid over. (1½)</li> <li>5.4 Supporting (documents) returns incorrectly completed and rejected by recipient. (1½)</li> </ul>
<b>c)</b> The functions would not change if Goingup (Pty) Ltd computerised its payroll cycle. How each function is carried out will change, for example, the preparation of the payroll will be carried out on the system (pay-out would be by EFT). However, there will still be a human resource section, computerised timekeeping, etc. (1½)	

**(1½ for each valid comment to a maximum of 22 marks)**

**Comments:**

For any question relating to weaknesses, risks or internal controls to be implemented, remember to always establish which cycle is applicable. Then ask which function is applicable and then "what" is asked? Weaknesses/risks/internal controls.

This is a good question to get an overview of the payroll cycle. It is broken down into the different functions with the corresponding risks associated with each function.

Remember that internal controls are put in place to reduce the risk that the business does not meet its objectives. Thus if no internal controls have been put in place over risks identified, that means that weaknesses are present in the client system of control.

Reference: Jackson & Stent (2014: 8/7 – 8/39 & 13/9 – 13/13)

1. a) Application control – mandatory field. (1½)  
b) This control contributes to the **prevention** of fictitious employees being added to the payroll. It is also designed to contribute to the **prevention** of the company employing illegal immigrants/aliens. (1½)
2. a) General control – systems development and implementation control. (1½)  
b) This control contributes to the overall **prevention** of invalid or otherwise inappropriate changes being made to software used by the company. (1½)
3. a) General control – access control. (1½)  
b) Prevents unauthorised access to the network at system level. It will be part of the company's overall access control policy to **prevent** unauthorised individuals from "getting onto the network" at all. (1½)
4. a) Application control – review. (1½)  
b) This is a **detective** control primarily. (1½)
5. a) General control – access control. (1½)  
b) Part of the company's overall access/custody control to **prevent** unauthorised access to its bank account so as to **prevent** theft of the company's cash resources and to prevent access to sensitive/confidential information. (1½)
6. a) General control – control environment, commitment to competence. (1½)  
b) Part of management's overall strategy to ensure the employees in the various departments (including payroll) are competent to do their jobs. This is part of **preventing** costly errors and subsequent losses arising from ignorance and incompetence. (1½)
7. a) Application control – review. (1½)  
b) **Detective** control to identify unauthorised/inaccurate masterfile amendments. (1½)
8. a) Application control and general control – access control. (1½)  
b) The comprehensive review of the payroll by Ziggi Puli is a **detective** application control to identify any errors or irregularities in the payroll. It is also **preventive** in that it is also designed to **prevent** incorrect or irregular transfers out of the company's bank account. The adoption of the "two signatory principle" is a general control implemented to prevent **any** unauthorised payments being made by EFT (protection of the company's cash reserves). (1½)
9. a) General control – participation by those charged with governance. (1½)  
b) This general control could be regarded as either or both part of the company's risk assessment process or monitoring process. Either way the policy is designed to **detect** risks and problems so that further occurrences of the risk or problems can be **prevented**. (1½)
10. a) Application control. (1½)  
b) The control is designed to **prevent** an employee from being remunerated for overtime which is invalid. (1½)

(1½ for each valid comment to a maximum of 20 marks)

**Comments:**

This question covers general vs application controls specifically in the payroll and personnel cycle. It is a good example of how topic 2 can be integrated into a question relating to a specific business cycle.

## Topic 8 Finance and Investment Cycle

### Feedback on supplementary Do questions on topic 8

#### QUESTION 12.9 IN GRADED QUESTIONS

40 marks

Reference: Jackson & Stent (2014: 5/5 – 5/17 & 14/2 – 14/5)

WEAKNESSES	RECOMMENDATION
<p>1. The acquisition (investment in) fixed assets is not <b>planned</b>. (1½)</p> <ul style="list-style-type: none"> <li>• There is no evaluation of whether the items purchased by the five sectional accountants are required. (1½)</li> <li>• Any member of the section can request equipment without providing proper motivation. (1½)</li> <li>• This is going to result in money being wasted on equipment which is not required or not suitable for the needs of the company. (1½)</li> <li>• It also provides an opportunity for misappropriation of equipment by employees. (1½)</li> </ul>	<ul style="list-style-type: none"> <li>• The company should appoint a fixed asset committee consisting of senior experienced management which will be responsible for <ul style="list-style-type: none"> <li>➢ evaluating the need for the purchase of capital expenditure. (1½)</li> <li>➢ and evaluating how capital expenditure will be financed. (1½)</li> </ul> </li> <li>• All requests for fixed assets from sections and individuals within a section must be fully motivated. (1½)</li> <li>• The fixed asset committee should be responsible for preparing an annual capital expenditure budget (see below). (1½)</li> </ul>
<p>2. The budgeting process is totally ineffective. (1½)</p> <ul style="list-style-type: none"> <li>• Simply increasing the prior year budget by an index has resulted in sections being allocated money which they do not require and which will be wasted. (1½)</li> <li>• This weakness is compounded by the fact that sections are “punished” for not spending their allocation by having their budgets reduced. (1½)</li> </ul>	<ul style="list-style-type: none"> <li>• A proper budgeting for capital expenditure system should be put in place (1½) <ul style="list-style-type: none"> <li>➢ each section should carefully evaluate their actual capital expenditure needs (and planned disposals) for the upcoming year. The budget should not be based on adjusted prior year figures. (1½)</li> <li>➢ the sectional budgets should be submitted to the fixed asset committee for their approval which should only be given after careful consideration of</li> </ul> </li> </ul>

WEAKNESSES	RECOMMENDATION
<ul style="list-style-type: none"> <li>This is evidenced by the fact that the sections rush to spend their allocations before the financial year-end resulting in many items of equipment lying about unopened/unused. (1½)</li> </ul>	<ul style="list-style-type: none"> <li>the motivation for the expenditure(1½)</li> <li>alternatives the overall budget for the business and other sections(1½)</li> <li>company cash flows(1½)</li> </ul> <ul style="list-style-type: none"> <li>should an item which appears in the budget <b>not</b> be required, it should <b>not</b> be purchased. (1½)</li> </ul> <ul style="list-style-type: none"> <li>there should be ongoing comparison of actual capital expenditure to budgeted expenditure. (1½)</li> </ul>
<p>3. There is inadequate authorisation of capital expenditure. (1½)</p> <ul style="list-style-type: none"> <li>Sectional accountants have complete authority to purchase equipment provided they have not exceeded the budget. (1½)</li> <li>Sectional accountants can therefore purchase unnecessary items for their own use at work (e.g. new computer every year, DSTV for the office, cell phones, etc) or which they may take home. (1½)</li> <li>In effect the sectional accountants can make a purchase and authorise it which is a lack of division of duties. (1½)</li> <li>Furthermore, as there appears to be no reconciliation or follow up of items actually purchased, this lack of division of duties becomes more serious (1½)</li> </ul>	<ul style="list-style-type: none"> <li>The fixed asset committee should approve the budget which will then become the fundamental authorising document. (1½)</li> <li>See points below (4)</li> </ul>
<p>4. The controls over the requisitioning and ordering and receipt of capital expenditure items are inadequate. (1½)</p> <ul style="list-style-type: none"> <li>No properly designed, pre-printed, sequenced (and authorised) requisition form is presented to support the purchase request (email is sent). (1½)</li> <li>The order is placed by the assistant to the sectional accountant (not the buying</li> </ul>	<ul style="list-style-type: none"> <li>A properly designed (two part) pre-printed, sequenced, capital expenditure requisition must be prepared and signed by a senior person in the section requiring the item e.g. warehouse manager requiring a new fork lift. (1½)</li> <li>This requisition should be submitted to the sectional accountant who should authorise the requisition (sign) <b>after</b> confirming that the request complies with the capital</li> </ul>

WEAKNESSES	RECOMMENDATION
<p>department) without any follow up with the supplier as to availability and price and <b>alternative</b> suppliers. (1½)</p> <ul style="list-style-type: none"> <li>• The person requisitioning the item stipulates the specific details and supplier which could easily result in the company paying higher prices because of employees directing business to friends or their own private business entities, e.g. the warehouse foreman may receive commission from a forklift company for directing business to it. (1½)</li> <li>• Items purchased should not be delivered to the individual sections as this weakens division of duties. (1½)</li> </ul>	<p>expenditure budget. (1½)</p> <ul style="list-style-type: none"> <li>• A copy of the requisition should be sent to the company buying department, and the second copy filed in numerical sequence. (1½)</li> <li>• The order department should: <ul style="list-style-type: none"> <li>➢ confirm that the goods requisitioned appear on the capital budget and if so (1½)</li> <li>➢ check with the preferred supplier as availability, current price, delivery particulars, etc, and (1½)</li> <li>➢ make out and sign a three part pre-printed, sequenced (capital expenditure) order (1½) <ul style="list-style-type: none"> <li>✓ Copy 1 – to the supplier (1½)</li> <li>✓ Copy 2 – to goods receiving department (1½)</li> <li>✓ Copy 3 – to accounting (1½)</li> </ul> </li> </ul> </li> <li>• Items purchased should be delivered to North Shore (Pty) Ltd's receiving department where a pre-printed, sequenced, three part "capital item goods received note" should be made out after the items delivered have been checked to the supplier delivery note. (1½) <ul style="list-style-type: none"> <li>➢ Copy 1 – sent with the items to the section (with Copy 3 as well) (1½)</li> <li>➢ Copy 2 – sent with supplier delivery note to accounting (1½)</li> <li>➢ Copy 3 – filed in receiving. (1½)</li> </ul> </li> </ul>

WEAKNESSES	RECOMMENDATION
<p>5. There is a serious lack of division of duties in respect of the assistant to the sectional accountant. This person</p> <ul style="list-style-type: none"> <li>• Places the order (on the strength of an email) (1½)</li> <li>• Receives the goods (1½) <ul style="list-style-type: none"> <li>• "authorises" payment (by sending the unchecked documentation to creditors) (1½)</li> </ul> </li> <li>• Writes up the records (fixed asset register) (1½)</li> </ul> <p>It would seem that it would not be too difficult for this person to misappropriate items of equipment for his or her own use (could even arrange to have the items delivered to his or her home.) (1½)</p>	<ul style="list-style-type: none"> <li>• The controls suggested above will also address this weakness.</li> <li>• On receipt of the item, a responsible official in the section should check the item delivered against the original requisition and the "capital item goods received notes", before signing them. (Copy 3 will be sent back to the receiving department and copy 1 retained in the section to be filed with the requisition.) (1½)</li> <li>• Once the above procedures are complete, the assistant to the sectional accountant can write up the sectional fixed asset register. However, it is preferable that a fixed asset register for the whole company is written up and controlled by an employee independent of the sections. (1½)</li> </ul>

(1½ for each valid comment to a maximum of 40 marks)

#### Comments:

This question required you to identify and explain weaknesses in the finance and investment cycle. You were also required to provide recommendations or improvements to the company's control activities/ internal controls in order to address the weaknesses identified.

The solution is presented in a table format. This is important because this is how the required asked you to structure your answer. There are usually presentation marks available for complying with the required.

Remember to READ your questions carefully. We've found that a big problem during exams and assignments is that students do not read the "required" carefully and therefore answer incorrectly and/or spend precious time answering what was not asked.

You would also have noticed that the weaknesses identified, are not just a "memory dump" from the theory, but theory applied to this specific scenario. Thus the application of the theory to a scenario is a skill that you must acquire as it will be of benefit to you in your later studies in auditing.

#### CONCLUDING REMARKS

Ons hoop dat u kennis van die onderwerpe verbeter het met die deurwerk van die vroeë en dat u nou beter toegerus is vir die eksamen. Die vroeë toets u kennis van die onderskeie onderwerpe, dus wanneer u die vroeë beantwoord, gebruik dit as 'n leer-geleentheid.